



Department  
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# Survivors, Executors, and Administrators

For use in preparing  
**2002** Returns



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## Important Changes

**Combat zone.** Special rules apply if a member of the Armed Forces of the United States dies while in active service in a combat zone or from wounds, disease, or injury incurred in a combat zone. See *Tax Forgiveness for Deaths Due to Military or Terrorist Actions*, later. For other tax information for members of the Armed Forces, see Publication 3, *Armed Forces' Tax Guide*.

**Benefits for public safety officers' survivors.** For tax years beginning after 2001, a survivor annuity received by the spouse, former spouse, or child of a public safety officer killed in the line of duty generally will be excluded from the recipient's income regardless of the date of the officer's death. Survivor benefits received before 2002 were excludable only if the officer died after 1996. The provision applies to a chaplain killed in the line of duty after September 10, 2001. For more information, see *Public safety officers*, later.

**Rollovers by surviving spouses.** For distributions after 2001, an employee's surviving spouse who receives an eligible rollover distribution may roll it over into an eligible retirement plan, including an IRA, a qualified plan, a section 403(b) annuity, or a section 457 plan. For plan distributions before 2002, surviving spouses could only roll the distribution over into an IRA.

**Estate tax return.** Generally, if the decedent died during 2002, an estate tax return (Form 706) must be filed if the gross estate is more than \$1,000,000.

**Estate tax repeal.** The estate tax is repealed for decedents dying after 2009.

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## Important Reminders

**Specified terrorist victim.** The *Victims of Terrorism Tax Relief Act of 2001* is explained in Publication 3920, *Tax Relief for Victims of Terrorist Attacks*. Under the Act, the federal income tax liability of those killed in the following attacks (specified terrorist victim) is forgiven for certain tax years.

- The April 19, 1995, terrorist attack on the Alfred P. Murrah Federal Building (Oklahoma City).
- The September 11, 2001, terrorist attacks.
- The terrorist attacks involving anthrax occurring after September 10, 2001, and before January 1, 2002.

The Act also exempts from federal income tax the following types of income.

- Qualified disaster relief payments made after September 10, 2001, to cover personal, family, living, or funeral expenses incurred because of a terrorist attack.
- Certain disability payments received in tax years ending after September 10, 2001, for injuries sustained in a terrorist attack.

- Certain death benefits paid by an employer to the survivor of an employee because the employee died as a result of a terrorist attack.
- Debt cancellations made after September 10, 2001, and before January 1, 2002, if the debts were cancelled because an individual died as a result of the September 11 attacks or the anthrax attacks.
- Payments from the September 11th Victim Compensation Fund of 2001.

The Act also reduces the estate tax of individuals who die as a result of a terrorist attack.

**Consistent treatment of estate and trust items.** Beneficiaries must generally treat estate items the same way on their individual returns as they are treated on the estate's return.

**Individual taxpayer identification number (ITIN).** The IRS will issue an ITIN to a nonresident or resident alien who does not have and is not eligible to get a social security number (SSN). To apply for an ITIN, file Form W-7, *Application for IRS Individual Taxpayer Identification Number*, with the IRS. It usually takes 4 to 6 weeks to get an ITIN.

An ITIN is for tax use only. It does not entitle the holder to social security benefits or change the holder's employment or immigration status under U.S. law.

**Photographs of missing children.** The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.

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## Introduction

This publication is designed to help those in charge of the property (estate) of an individual who has died (decedent). It shows them how to complete and file federal income tax returns and points out their responsibility to pay any taxes due.

A comprehensive example, using tax forms, is included near the end of this publication. Also included at the end of this publication are the following items.

- A checklist of the forms you may need and their due dates.
- A worksheet to reconcile amounts reported in the decedent's name on information Forms W-2, 1099-INT, 1099-DIV, etc. The worksheet will help you correctly determine the income to report on the decedent's final return and on the return for either the estate or a beneficiary.

**Comments and suggestions.** We welcome your comments about this publication and your suggestions for future editions.

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We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

## Useful Items

You may want to see:

### Publication

- 950** Introduction to Estate and Gift Taxes
- 3920** Tax Relief for Victims of Terrorist Attacks

### Form (and Instructions)

- 1040** U.S. Individual Income Tax Return
- 1041** U.S. Income Tax Return for Estates and Trusts
- 706** United States Estate (and Generation-Skipping Transfer) Tax Return
- 1310** Statement of Person Claiming Refund Due a Deceased Taxpayer

See *How To Get Tax Help* near the end of this publication for information about getting publications and forms.

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## Personal Representative

A **personal representative** of an estate is an executor, administrator, or anyone who is in charge of the decedent's property. Generally, an **executor** (or executrix) is named in a decedent's will to administer the estate and distribute properties as the decedent has directed. An **administrator** (or administratrix) is usually appointed by the court if no will exists, if no executor was named in the will, or if the named executor cannot or will not serve.

In general, an executor and an administrator perform the same duties and have the same responsibilities.

For estate tax purposes, if there is no executor or administrator appointed, qualified, and acting within the United States, the term executor includes anyone in actual or constructive possession of any property of the decedent. It includes, among others, the decedent's agents and representatives; safe-deposit companies, warehouse companies, and other custodians of property in this country; brokers holding securities of the decedent as collateral; and the debtors of the decedent who are in this country.

A personal representative for a decedent's estate can be an executor, administrator, or anyone in charge of the decedent's property, so the term personal representative will be used throughout this publication.

## Duties

The primary duties of a personal representative are to collect all the decedent's assets, pay the creditors, and distribute the remaining assets to the heirs or other beneficiaries.

The personal representative also must perform the following duties.

- File any income tax return and the estate tax return when due.
- Pay the tax determined up to the date of discharge from duties.

Other duties of the personal representative in federal tax matters are discussed in other sections of this publication. If any beneficiary is a nonresident alien, see Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*, for information on the personal representative's duties as a withholding agent.

**Penalty.** There is a penalty for failure to file a tax return when due unless the failure is due to reasonable cause. Reliance on an agent (attorney, accountant, etc.) is not reasonable cause for late filing. It is the personal representative's duty to file the returns for the decedent and the estate when due.

**Identification number.** The first action you should take if you are the personal representative for the decedent is to apply for an **employer identification number (EIN)** for the estate. You should apply for this number as soon as possible because you need to enter it on returns, statements, and other documents that you file concerning the estate. You also must give the number to payers of interest and dividends and other payers who must file a return concerning the estate. You must apply for the number using **Form SS-4, Application for Employer Identification Number**. Generally, if you apply by mail, it takes about 4 weeks to get your EIN. However, you can apply by phone and get it immediately. (You still need Form SS-4.) See the form instructions for how to apply.

Payers of interest and dividends report amounts on Forms 1099 using the identification number of the person to whom the account is payable. After a decedent's death, the Forms 1099 must reflect the identification number of the estate or beneficiary to whom the amounts are payable. As the personal representative handling the estate you must furnish this identification number to the payer. For example, if interest is payable to the estate, the estate's EIN number must be provided to the payer and used to report the interest on Form 1099-INT, *Interest Income*. If the interest is payable to a surviving joint owner, the survivor's identification number must be provided to the payer and used to report the interest.

The deceased individual's identifying number must not be used to file an individual tax return after the decedent's final tax return. It also must not be used to make estimated tax payments for a tax year after the year of death.

**Penalty.** If you do not include the EIN on any return, statement, or other document, you are liable for a penalty for each failure, unless you can show reasonable cause. You also are liable for a penalty if you do not give the EIN to another person, or if you do not include the taxpayer identification number of another person on a return, statement, or other document.

**Notice of fiduciary relationship.** The term fiduciary means any person acting for another person. It applies to persons who have positions of trust on behalf of others. A personal representative for a decedent's estate is a fiduciary.

If you are appointed to act in any fiduciary capacity for another, you must file a written notice with the IRS stating this. **Form 56, Notice Concerning Fiduciary Relationship**, can be used for this purpose. The instructions and other requirements are given on the back of the form.

You should file the written notice (or Form 56) as soon as all of the necessary information (including the EIN) is available. It notifies the IRS that, as the fiduciary, you are assuming the powers, rights, duties, and privileges of the decedent, and allows the IRS to mail to you all tax notices concerning the person (or estate) you represent. The notice remains in effect until you notify the appropriate IRS office that your relationship to the estate has terminated.

**Termination notice.** When you are relieved of your responsibilities as personal representative, you must advise the IRS office where you filed the written notice (or Form 56) either that the estate has been terminated or that your successor has been appointed. Use Form 56 for the termination notice by completing the appropriate part on the form. If another person has been appointed to succeed you as the personal representative, you should give the name and address of your successor.

**Request for prompt assessment (charge) of tax.** The IRS ordinarily has 3 years from the date an income tax return is filed, or its due date, whichever is later, to charge any additional tax that is due. However, as a personal representative you may request a prompt assessment of tax after the return has been filed. This reduces the time for making the assessment to 18 months from the date the written request for prompt assessment was received. This request can be made for any income tax return of the decedent and for the income tax return of the decedent's estate. This may permit a quicker settlement of the tax liability of the estate and an earlier final distribution of the assets to the beneficiaries.

**Form 4810.** Form 4810, *Request for Prompt Assessment Under Internal Revenue Code Section 6501(d)*, can be used for making this request. It must be filed separately from any other document. The request should be filed with the IRS office where the return was filed. If Form 4810 is not used, you must clearly indicate that you are making a request for prompt assessment under section 6501(d) of the Internal Revenue Code. You must identify the type of tax and the tax period for which the prompt assessment is requested.


As the personal representative for the decedent's estate, you are responsible for any additional taxes that may be due. You can request prompt assessment of any of the decedent's taxes (other than federal estate taxes) for any years for which the statutory period for assessment is open. This applies even though the returns were filed before the decedent's death.

**Failure to report income.** If you or the decedent failed to report substantial amounts of

gross income (more than 25% of the gross income reported on the return) or filed a false or fraudulent return, your request for prompt assessment will not shorten the period during which the IRS may assess the additional tax. However, such a request may relieve you of personal liability for the tax if you did not have knowledge of the unpaid tax.

**Request for discharge from personal liability for tax.** An executor can make a written request for discharge from personal liability for a decedent's income and gift taxes. The request must be made after the returns for those taxes are filed. It must clearly indicate that the request is for discharge from personal liability under section 6905 of the Internal Revenue Code. For this purpose, an executor is an executor or administrator that is appointed, qualified, and acting within the United States.

Within 9 months after receipt of the request, the IRS will notify the executor of the amount of taxes due. If this amount is paid, the executor will be discharged from personal liability for any future deficiencies. If the IRS has not notified the executor, he or she will be discharged from personal liability at the end of the 9-month period.

 *Even if the executor is discharged from personal liability, the IRS will still be able to assess tax deficiencies against the executor to the extent that he or she still has any of the decedent's property.*

**Insolvent estate.** Generally, if a decedent's estate is insufficient to pay all the decedent's debts, the debts due the United States must be paid first. Both the decedent's federal income tax liabilities at the time of death and the estate's income tax liability are debts due the United States. The personal representative of an insolvent estate is personally responsible for any tax liability of the decedent or of the estate if he or she had notice of such tax obligations or had failed to exercise due care in determining if such obligations existed before distribution of the estate's assets and before being discharged from duties. The extent of such personal responsibility is the amount of any other payments made before paying the debts due the United States, except where such other debt paid has priority over the debts due the United States. The income tax liabilities need not be formally assessed for the personal representative to be liable if he or she was aware or should have been aware of their existence.

## Fees Received by Personal Representatives

All personal representatives must include in their gross income fees paid to them from an estate. If paid to a professional executor or administrator, self-employment tax also applies to such fees. For a nonprofessional executor or administrator (a person serving in such capacity in an isolated instance, such as a friend or relative of the decedent), self-employment tax only applies if a trade or business is included in the estate's assets, the executor actively participates in the business, and the fees are related to operation of the business.



# Final Return for Decedent

The personal representative (defined earlier) must file the final income tax return (Form 1040) of the decedent for the year of death and any returns not filed for preceding years. A surviving spouse, under certain circumstances, may have to file the returns for the decedent. See *Joint Return*, later.

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

**Example.** Samantha Smith died on March 21, 2002, before filing her 2001 tax return. Her personal representative must file her 2001 return by April 15, 2002. Her final tax return is due April 15, 2003.

## Filing Requirements

The gross income, age, and filing status of a decedent generally determine whether a return must be filed. Gross income usually is all income received by an individual in the form of money, goods, property, and services that is not tax-exempt. It includes gross receipts from self-employment but if the business involves manufacturing, merchandising, or mining, subtract any cost of goods sold. In general, filing status depends on whether the decedent was considered single or married at the time of death. See the income tax return instructions or Publication 501, *Exemptions, Standard Deduction, and Filing Information*.

## Refund

A return should be filed to obtain a refund if tax was withheld from salaries, wages, pensions, or annuities, or if estimated tax was paid, even if a return is not required to be filed. Also, the decedent may be entitled to other credits that result in a refund. These advance payments of tax and credits are discussed later under *Credits, Other Taxes, and Payments*.

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

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

**Example.** Mr. Green died before filing his tax return. You were appointed the personal

representative for Mr. Green's estate, and you file his Form 1040 showing a refund due. You do not need Form 1310 to claim the refund if you attach a copy of the court certificate showing you were appointed the personal representative.



*If you are a surviving spouse and you receive a tax refund check in both your name and your deceased spouse's name, you can have the check reissued in your name alone. Return the joint-name check and a completed Form 1310 to your local IRS office or the service center where you mailed your return. A new check will be issued in your name and mailed to you.*

## Nonresident Alien

If the decedent was a nonresident alien who would have had to file Form 1040NR, *U.S. Nonresident Alien Income Tax Return*, you must file that form for the decedent's final tax year. See the instructions for Form 1040NR for the filing requirements, due date, and where to file.

## Joint Return

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

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

For information about tax benefits to which a surviving spouse may be entitled, see *Tax Benefits for Survivors*, later, under *Other Tax Information*.

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

## Income To Include

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

section explains how some types of income are reported on the final return.

For more information about accounting methods, see Publication 538, *Accounting Periods and Methods*.

## Under the Cash Method

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

**Constructive receipt of income.** Interest from coupons on the decedent's bonds was constructively received by the decedent if the coupons matured in the decedent's final tax year, but had not been cashed. Include the interest in the final return.

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

## Under an Accrual Method

Generally, under an accrual method of accounting, income is reported when earned.

If the decedent used an accrual method, only the income items normally accrued before death are included in the final return.

## Partnership Income

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

On the decedent's final return, include the decedent's distributive share of partnership items for the following periods.

- 1) The partnership's tax year that ended within or with the decedent's final tax year (the year ending on the date of death).
- 2) The period, if any, from the end of the partnership's tax year in (1) to the decedent's date of death.

**Example.** Mary Smith was a partner in XYZ partnership and reported her income on a tax year ending December 31. The partnership uses a tax year ending June 30. Mary died August 31, 2002, and her estate established its tax year through August 31.

The distributive share of partnership items based on the decedent's partnership interest is reported as follows.

- Final Return for the Decedent — January 1 through August 31, 2002, includes XYZ

partnership items from (a) the partnership tax year ending June 30, 2002, and (b) the partnership tax year beginning July 1, 2002, and ending August 31, 2002 (the date of death).

- Income Tax Return of the Estate — September 1, 2002, through August 31, 2003, includes XYZ partnership items for the period September 1, 2002, through June 30, 2003.

## S Corporation Income

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

- 1) The corporation's tax year that ended within or with the decedent's final tax year (the year ending on the date of death).
- 2) The period, if any, from the end of the corporation's tax year in (1) to the decedent's date of death.

## Self-Employment Income

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

## Community Income

If the decedent was married and was domiciled in a community property state, half of the income received and half of the expenses paid during the decedent's tax year by either the decedent or spouse may be considered to be the income and expenses of the other. For more information, see Publication 555, *Community Property*.

## Interest and Dividend Income (Forms 1099)

A Form 1099 should be received for the decedent reporting interest and dividends earned before death and included on the decedent's final return. A separate Form 1099 should show the interest and dividends earned after the date of the decedent's death and paid to the estate or other recipient that must include those amounts on its return. You can request corrected Forms 1099 if these forms do not properly reflect the right recipient or amounts.

For example, a Form 1099-INT reporting interest payable to the decedent may include income that should be reported on the final income tax return of the decedent, as well as income that the estate or other recipient should report, either as income earned after death or as income in respect of the decedent (discussed later). For income earned after death, you

should ask the payer for a Form 1099 that properly identifies the recipient (by name and identification number) and the proper amount. If that is not possible, or if the form includes an amount that represents income in respect of the decedent, report the interest as shown next under *How to report*.

See *U.S. savings bonds acquired from decedent under Income in Respect of the Decedent*, later, for information on savings bond interest that may have to be reported on the final return.

**How to report.** If you are preparing the decedent's final return and you have received a Form 1099-INT for the decedent that includes amounts belonging to the decedent and to another recipient (the decedent's estate or another beneficiary), report the total interest shown on Form 1099-INT on Schedule 1 (Form 1040A) or on Schedule B (Form 1040). Next, enter a subtotal of the interest shown on Forms 1099, and the interest reportable from other sources for which you did not receive Forms 1099. Then, show any interest (including any interest you receive as a nominee) belonging to another recipient separately and subtract it from the subtotal. Identify the amount of this adjustment as "Nominee Distribution" or other appropriate designation.

Report dividend income for which you received a Form 1099-DIV, *Dividends and Distributions*, on the appropriate schedule using the same procedure.

**Note.** If the decedent received amounts as a nominee, you must give the actual owner a Form 1099, unless the owner is the decedent's spouse.

## Archer MSA

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

If a beneficiary acquires the interest, see the discussion under *Income in Respect of the Decedent*, later. For other information on Archer MSAs, see Publication 969, *Medical Savings Accounts (MSAs)*.

## Coverdell Education Savings Account (ESA)

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

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

For more information on Coverdell ESAs, see Publication 970, *Tax Benefits for Education*.

## Accelerated Death Benefits

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

Generally, if the decedent received accelerated death benefits either on his or her own life or on the life of another person, those benefits are not included in the decedent's income. This exclusion applies only if the insured was a terminally or chronically ill individual. For more information, see the discussion under *Gifts, Insurance, and Inheritances under Other Tax Information*, later.

## Exemptions and Deductions

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

## Exemptions

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

## Standard Deduction

If you do not itemize deductions on the final return, the full amount of the appropriate standard deduction is allowed regardless of the date of death. For information on the appropriate standard deduction, see the income tax return instructions or Publication 501.

## Medical Expenses

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



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

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

If you make the election, you can claim all or part of the expenses on the decedent's income tax return, if deductions are itemized, rather than on the federal estate tax return (Form 706). You can deduct expenses incurred in the year of death on the final income tax return. You should file an amended return (Form 1040X) for medical expenses incurred in an earlier year, unless the statutory period for filing a claim for that year has expired.

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

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

**Example.** Richard Brown used the cash method of accounting and filed his income tax return on a calendar year basis. Mr. Brown died on June 1, 2002, after incurring \$800 in medical expenses. Of that amount, \$500 was incurred in 2001 and \$300 was incurred in 2002. Richard itemized his deductions when he filed his 2001 income tax return. The personal representative of the estate paid the entire \$800 liability in August 2002.

The personal representative may file an amended return (Form 1040X) for 2001 claiming the \$500 medical expense as a deduction, subject to the 7.5% limit. The \$300 of expenses incurred in 2002 can be deducted on the final income tax return if deductions are itemized, subject to the 7.5% limit. The personal representative must file a statement in duplicate with each return stating that these amounts have not been claimed on the federal estate tax return (Form 706), and waiving the right to claim such a deduction on Form 706 in the future.

**Medical expenses not paid by estate.** If you paid medical expenses for your deceased spouse or dependent, claim the expenses on your tax return for the year in which you paid them, whether they are paid before or after the decedent's death. If the decedent was a child of divorced or separated parents, the medical expenses can usually be claimed by both the custodial and noncustodial parent to the extent paid by that parent during the year.

**Insurance reimbursements.** Insurance reimbursements of previously deducted medical ex-

penses due a decedent at the time of death and later received by the decedent's estate are includible in the income tax return of the estate (Form 1041) for the year the reimbursements are received. The reimbursements are also includible in the decedent's gross estate.

## Deduction for Losses

A decedent's net operating loss deduction from a prior year and any capital losses (including capital loss carryovers) can be deducted only on the decedent's final income tax return. A net operating loss on the decedent's final income tax return can be carried back to prior years. (See Publication 536, *Net Operating Losses (NOLs) for Individuals, Estates, and Trusts.*) You cannot deduct any unused net operating loss or capital loss on the estate's income tax return.

**At-risk loss limits.** Special at-risk rules apply to most activities that are engaged in as a trade or business or for the production of income.

These rules limit the amount of deductible loss to the amount for which the individual was considered at risk in the activity. An individual generally will be considered at risk to the extent of the money and the adjusted basis of property that he or she contributed to the activity and certain amounts the individual borrowed for use in the activity. An individual will be considered at risk for amounts borrowed only if he or she was personally liable for the repayment or if the amounts borrowed were secured by property other than that used in the activity. The individual is not considered at risk for borrowed amounts if the lender has an interest in the activity or if the lender is related to a person who has an interest in the activity. For more information, see Publication 925, *Passive Activity and At-Risk Rules.*

**Passive activity rules.** A passive activity is any trade or business activity in which the taxpayer does not materially participate. To determine material participation, see Publication 925. Rental activities are passive activities regardless of the taxpayer's participation, unless the taxpayer meets certain eligibility requirements.

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

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

Use Form 8582, *Passive Activity Loss Limitations*, to summarize losses and income from passive activities and to figure the amounts allowed. For more information, see Publication 925.

## Credits, Other Taxes, and Payments

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

### Credits

You can claim on the final income tax return any tax credits that applied to the decedent before death. Some of these credits are discussed next.

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

For more information, see Publication 596, *Earned Income Credit (EIC).*

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

For more information, see Publication 524, *Credit for the Elderly or the Disabled.*

**Child tax credit.** If the decedent had a qualifying child, you may be able to claim the child tax credit on the decedent's final return even though the return covers less than 12 months. You may be able to claim the additional child tax credit and get a refund if the credit is more than the decedent's liability. For more information, see your form instructions.

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

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

For more information on the general business credit, see Publication 334, *Tax Guide for Small Business.*

### Other Taxes

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

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

- 1) Net earnings from self-employment (excluding income described in (2)) were \$400 or more.



- 2) Wages from services performed as a church employee were \$108.28 or more.

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

**Form 6251.** Use Form 6251, *Alternative Minimum Tax—Individuals*, to determine if this tax applies to the decedent. See the form instructions for information on when you must attach the form to the tax return.

## Payments of Tax

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

## Name, Address, and Signature

The word "DECEASED," the decedent's name, and the date of death should be written across the top of the tax return. In the name and address space you should write the name and address of the decedent and, if a joint return, of the surviving spouse. If a joint return is not being filed, the decedent's name should be written in the name space and the personal representative's name and address should be written in the remaining space.

**Third party designee.** You can check the Yes box in the Third Party Designee area of the return to authorize the IRS to discuss the return with a friend, family member, or any other person you choose. This allows the IRS to call the person you identified as the designee to answer any questions that may arise during the processing of the return. It also allows the designee to perform certain actions. See the income tax package for details.

**Signature.** If a personal representative has been appointed, that person must sign the return. If it is a joint return, the surviving spouse must also sign it. If no personal representative has been appointed, the surviving spouse (on a joint return) should sign the return and write in the signature area "Filing as surviving spouse." If no personal representative has been appointed and if there is no surviving spouse, the person in charge of the decedent's property must file and sign the return as "personal representative."

**Paid preparer.** If you pay someone to prepare, assist in preparing, or review the tax return, that person must sign the return and fill in the other blanks in the paid preparer's area of the return. See the income tax package for details.

## When and Where To File

The final income tax return is due at the same time the decedent's return would have been due

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

The tax return must be prepared on a form for the year of death regardless of when during the year death occurred.

Generally, you must file the final income tax return of the decedent with the Internal Revenue Service center for the place where you live. A tax return for a decedent can be electronically filed.

## Tax Forgiveness for Deaths Due to Military or Terrorist Actions

The decedent's income tax liability may be forgiven if his or her death was due to service in a combat zone or to military or terrorist actions.



*The Victims of Terrorism Tax Relief Act of 2001 provides tax relief for those injured or killed as a result of terrorist attacks, certain survivors of those killed as a result of terrorist attacks, and others who were affected by terrorist attacks. For information on that Act, see Publication 3920.*

### Combat Zone

If a member of the Armed Forces of the United States dies while in active service in a combat zone or from wounds, disease, or injury incurred in a combat zone, the decedent's income tax liability is abated (forgiven) for the entire year in which death occurred and for any prior tax year ending on or after the first day the person served in a combat zone in active service. For this purpose, a qualified hazardous duty area is treated as a combat zone.

If the tax (including interest, additions to the tax, and additional amounts) for these years has been assessed, the assessment will be forgiven. If the tax has been collected (regardless of the date of collection), that tax will be credited or refunded.

Any of the decedent's income tax for tax years before those mentioned above that remains unpaid as of the actual (or presumptive) date of death will not be assessed. If any unpaid tax (including interest, additions to the tax, and additional amounts) has been assessed, this assessment will be forgiven. Also, if any tax was collected after the date of death, that amount will be credited or refunded.

The date of death of a member of the Armed Forces reported as missing in action or as a prisoner of war is the date his or her name is removed from missing status for military pay purposes. This is true even if death actually occurred earlier.

### Military or Terrorist Actions

The decedent's income tax liability is forgiven if, at death, he or she was a military or civilian employee of the United States who died because of wounds or injury incurred:

- While a U.S. employee, and

- In a military or terrorist action.

The forgiveness applies to the tax year in which death occurred and for any prior tax year in the period beginning with the year before the year in which the wounds or injury occurred.

**Example.** The income tax liability of a civilian employee of the United States who died in 2002 because of wounds incurred while a U.S. employee in a terrorist attack that occurred in 1989 will be forgiven for 2002 and for all prior tax years in the period 1988–2001. Refunds are allowed for the tax years for which the period for filing a claim for refund has not ended, as discussed later.

**Military or terrorist action defined.** A military or terrorist action means the following.

- Any terrorist activity that most of the evidence indicates was directed against the United States or any of its allies.
- Any military action involving the U.S. Armed Forces and resulting from violence or aggression against the United States or any of its allies, or the threat of such violence or aggression.

Military action does not include training exercises. Any multinational force in which the United States is participating is treated as an ally of the United States.

### Claim for Credit or Refund

If any of these tax-forgiveness situations applies to a prior year tax, any tax paid for which the period for filing a claim has not ended will be credited or refunded. If any tax is still due, it will be canceled. The normal period for filing a claim for credit or refund is 3 years after the return was filed or 2 years after the tax was paid, whichever is later.

If death occurred in a combat zone or from wounds, disease, or injury incurred in a combat zone, the period for filing the claim is extended by:

- 1) The amount of time served in the combat zone (including any period in which the individual was in missing status), plus
- 2) The period of continuous qualified hospitalization for injury from service in the combat zone, if any, plus
- 3) The next 180 days.

Qualified hospitalization means any hospitalization outside the United States and any hospitalization in the United States of not more than 5 years.

**Filing a claim.** Use the following procedures to file a claim.

- 1) If a U.S. individual income tax return (Form 1040, 1040A, or 1040EZ) has not been filed, you should make a claim for refund of any withheld income tax or estimated tax payments by filing Form 1040. Form W-2, *Wage and Tax Statement*, must accompany all returns.
- 2) If a U.S. individual income tax return has been filed, you should make a claim for refund by filing Form 1040X. You must file

a separate Form 1040X for each year in question.



You must file these returns and claims at the following address for regular mail (U.S. Postal Service):

Internal Revenue Service  
P.O. Box 4053  
Woburn, MA 01888

For private delivery services use the following address:

Internal Revenue Service  
310 Lowell Street  
Stop 661  
Andover, MA 01810

Identify all returns and claims for refund by writing "Enduring Freedom — KIA," "Kosovo Operation — KIA," "Desert Storm — KIA," or "Former Yugoslavia — KIA" in bold letters on the top of page 1 of the return or claim. On Forms 1040 and 1040X, write the same phrase on the line for total tax. If the individual was killed in a terrorist or military action, put "KITA" on the front of the return and on the line for total tax.

An attachment should include a computation of the decedent's tax liability and a computation of the amount that is to be forgiven. On joint returns, you must make an allocation of the tax as described later under *Joint returns*. If you cannot make a proper allocation, you should attach a statement of all income and deductions allocable to each spouse and the IRS will make the proper allocation.

You must attach Form 1310 to all returns and claims for refund. However, for exceptions to filing Form 1310, see *Form 1310* under *Refund*, earlier.

If you have to attach Form 1310, you must have proof of death. The proof of death must be an authentic copy of either the death certificate or the formal notification from the appropriate government office (such as the Department of Defense) informing the next of kin of the decedent's death. Keep the proof of death with your records. Do not attach it to Form 1310.

If the certification has been received, but you do not have enough tax information to file a timely claim for refund, you can suspend the period for filing a claim by filing Form 1040X. Attach Form 1310 and a statement that you will file an amended claim as soon as you have the required tax information.

**Joint returns.** If a joint return was filed, only the decedent's part of the income tax liability is eligible for forgiveness. Determine the decedent's tax liability as follows.

- 1) Figure the income tax for which the decedent would have been liable if a separate return had been filed.
- 2) Figure the income tax for which the spouse would have been liable if a separate return had been filed.
- 3) Multiply the joint tax liability by a fraction. The numerator of the fraction is the amount in (1), above. The denominator of the fraction is the total of (1) and (2).

The amount in (3) above is the decedent's tax liability that is eligible for forgiveness.

## Filing Reminders

To minimize the time needed to process the decedent's final return and issue any refund, be sure to follow these procedures.

- 1) Write "DECEASED," the decedent's name, and the date of death across the top of the tax return.
- 2) If a personal representative has been appointed, the personal representative must sign the return. If it is a joint return, the surviving spouse must also sign it.
- 3) If you are the decedent's spouse filing a joint return with the decedent and no personal representative has been appointed, write "Filing as surviving spouse" in the area where you sign the return.
- 4) If no personal representative has been appointed and if there is no surviving spouse, the person in charge of the decedent's property must file and sign the return as "personal representative."
- 5) To claim a refund for the decedent, do the following.
  - a) If you are the decedent's spouse filing a joint return with the decedent, file only the tax return to claim the refund.
  - b) If you are the personal representative and the return is not a joint return filed with the decedent's surviving spouse, file the return and attach a copy of the certificate that shows your appointment by the court. (A power of attorney or a copy of the decedent's will is not acceptable evidence of your appointment as the personal representative.) If you are filing an amended return, attach Form 1310 and a copy of the certificate of appointment (or, if you have already sent the certificate of appointment to IRS, write "Certificate Previously Filed" at the bottom of Form 1310).
  - c) If you are not filing a joint return as the surviving spouse and a personal representative has not been appointed, file the return and attach Form 1310.

## Other Tax Information

This section contains information about the effect of an individual's death on the income tax liability of the survivors (including widows and widowers), the beneficiaries, and the estate.

### Tax Benefits for Survivors

Survivors can qualify for certain benefits when filing their own income tax returns.

**Joint return by surviving spouse.** A surviving spouse can file a joint return for the year of death and may qualify for special tax rates for the following 2 years, as explained under *Qualifying widows and widowers*, later.

**Decedent as your dependent.** If the decedent qualified as your dependent for the part of the year before death, you can claim the exemp-

tion for the dependent on your tax return, regardless of when death occurred during the year.

If the decedent was your qualifying child, you may be able to claim the child tax credit or the earned income credit.

**Qualifying widows and widowers.** If your spouse died within the 2 tax years preceding the year for which your return is being filed, you may be eligible to claim the filing status of qualifying widow(er) with dependent child and qualify to use the *Married filing jointly* tax rates.

**Requirements.** Generally, you qualify for this special benefit if you meet all of the following requirements.

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

**Example.** William Burns' wife died in 2000. Mr. Burns has not remarried and continued throughout 2001 and 2002 to maintain a home for himself and his dependent child. For 2000 he was entitled to file a joint return for himself and his deceased wife. For 2001 and 2002, he qualifies to file as a qualifying widow(er) with dependent child. For later years, he may qualify to file as a head of household.

**Figuring your tax.** Check the box on line 5 (Form 1040 or 1040A) under filing status on your tax return and enter the year of death in the parentheses. Use the Tax Rate Schedule or the column in the Tax Table for *Married filing jointly*, which gives you the split-income benefits.

The last year you can file jointly with, or claim an exemption for, your deceased spouse is the year of death.

**Joint return filing rules.** If you are the surviving spouse and a personal representative is handling the estate for the decedent, you should coordinate filing your return for the year of death with this personal representative. See *Joint Return* earlier under *Final Return for Decedent*.

### Income in Respect of the Decedent

All income that the decedent would have received had death not occurred, that was not properly includible on the final return, discussed earlier, is income in respect of the decedent.



If the decedent is a specified terrorist victim (see Important Reminders), any income received after the date of death and before the end of the decedent's tax year (determined without regard to death) is excluded from the recipient's gross income. This exclusion does not apply to certain income. For more information, see Publication 3920.



## How To Report

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

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



*If you have to include income in respect of the decedent in your income, you may be able to claim a deduction for the estate tax paid on that income. See Estate Tax Deduction, later.*

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

**Example 2.** Assume the same facts as in Example 1, except that Frank used the accrual method of accounting. The amount accrued from the sale of the apples would be included on his final return. Neither the estate nor the widow would realize income in respect of the decedent when the money is later paid.

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

**Example 4.** Cathy O'Neil was entitled to a large salary payment at the date of her death. The amount was to be paid in five annual installments. The estate, after collecting two installments, distributed the right to the remaining installments to you, the beneficiary. The payments are income in respect of the decedent. None of the payments were includible on Cathy's final return. The estate must include in its income the two installments it received, and you must include in your income each of the three installments as you receive them.

**Example 5.** You inherited the right to receive renewal commissions on life insurance sold by your father before his death. You inherited the right from your mother, who acquired it by bequest from your father. Your mother died before she received all the commissions she had the right to receive, so you received the rest. The commissions are income in respect of the

decedent. None of these commissions were includible in your father's final return. The commissions received by your mother were included in her income. The commissions you received are not includible in your mother's income, even on her final return. You must include them in your income.

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

**Transfer of right to income.** If you transfer your right to income in respect of a decedent, you must include in your income the greater of:

- The amount you receive for the right, or
- The fair market value of the right you transfer.

If you make a gift of such a right, you must include in your income the fair market value of the right at the time of the gift.

If the right to income from an installment obligation is transferred, the amount you must include in income is reduced by the basis of the obligation. See *Installment obligations*, later.

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

**Installment obligations.** If the decedent had sold property using the installment method and you collect payments on an installment obligation you acquired from the decedent, use the same gross profit percentage the decedent used to figure the part of each payment that represents profit. Include in your income the same profit the decedent would have included had death not occurred. For more information, see Publication 537, *Installment Sales*.

If you dispose of an installment obligation acquired from a decedent (other than by transfer to the obligor), the rules explained in Publication 537 for figuring gain or loss on the disposition apply to you.

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

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

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

## Specific Types of Income in Respect of a Decedent

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

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

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

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

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

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

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

**Partnership income.** If the partner who died had been receiving payments representing a distributive share or guaranteed payment in liquidation of the partner's interest in a partnership, the remaining payments made to the estate or other successor in interest are income in respect of the decedent. The estate or the successor

receiving the payments must include them in income when received. Similarly, the estate or other successor in interest receives income in respect of a decedent if amounts are paid by a third person in exchange for the successor's right to the future payments.

For a discussion of partnership rules, see Publication 541, *Partnerships*.

#### **U.S. savings bonds acquired from decedent.**

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

The redemption values of U.S. savings bonds generally are available from local banks, savings and loan institutions, or your nearest Federal Reserve Bank.

You also can get information by writing to the following address.



Bureau of the Public Debt  
P.O. Box 1328  
Parkersburg, WV 26106-1328



Or, on the Internet, visit the following site.  
[www.publicdebt.treas.gov](http://www.publicdebt.treas.gov)

If the bonds transferred because of death were owned by a cash method individual who had not chosen to report the interest each year and had purchased the bonds entirely with personal funds, interest earned before death must be reported in one of the following ways.

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

**Example 1.** Your uncle, a cash method taxpayer, died and left you a \$1,000 series EE bond. He had bought the bond for \$500 and had not chosen to report the increase in value each year. At the date of death, interest of \$94 had accrued on the bond, and its value of \$594 at date of death was included in your uncle's es-

tate. Your uncle's personal representative did not choose to include the \$94 accrued interest in the decedent's final income tax return. You are a cash method taxpayer and do not choose to report the increase in value each year as it is earned. Assuming you cash it when it reaches maturity value of \$1,000, you would report \$500 interest income (the difference between maturity value of \$1,000 and the original cost of \$500) in that year. You also are entitled to claim, in that year, a deduction for any federal estate tax resulting from the inclusion in your uncle's estate of the \$94 increase in value.

**Example 2.** If, in *Example 1*, the personal representative had chosen to include the \$94 interest earned on the bond before death in the final income tax return of your uncle, you would report \$406 (\$500 - \$94) as interest when you cashed the bond at maturity. This \$406 represents the interest earned after your uncle's death and was not included in his estate, so no deduction for federal estate tax is allowable for this amount.

**Example 3.** Your uncle died owning series HH bonds that he acquired in exchange for series EE bonds. You were the beneficiary on these bonds. Your uncle used the cash method of accounting and had not chosen to report the increase in redemption price of the series EE bonds each year as it accrued. Your uncle's personal representative made no election to include any interest earned before death in the decedent's final return. Your income in respect of the decedent is the sum of the unreported increase in value of the series EE bonds, which constituted part of the amount paid for series HH bonds, and the interest, if any, payable on the series HH bonds but not received as of the date of the decedent's death.

**Specific dollar amount legacy satisfied by transfer of bonds.** If you receive series EE or series I bonds from an estate in satisfaction of a specific dollar amount legacy and the decedent was a cash method taxpayer who did not elect to report interest each year, only the interest earned after you receive the bonds is your income. The interest earned to the date of death plus any further interest earned to the date of distribution is income to (and reportable by) the estate.

**Cashing U.S. savings bonds.** When you cash a U.S. savings bond that you acquired from a decedent, the bank or other payer that redeems it must give you a Form 1099-INT if the interest part of the payment you receive is \$10 or more. Your Form 1099-INT should show the difference between the amount received and the cost of the bond. The interest shown on your Form 1099-INT will not be reduced by any interest reported by the decedent before death, or, if elected, by the personal representative on the final income tax return of the decedent, or by the estate on the estate's income tax return. Your Form 1099-INT may show more interest than you must include in your income.

You must make an adjustment on your tax return to report the correct amount of interest. Report the total interest shown on Form 1099-INT on your Schedule 1 (Form 1040A) or Schedule B (Form 1040). Enter a subtotal of the interest shown on Forms 1099, and the interest reportable from other sources for which you did

not receive Forms 1099. Show the total interest that was previously reported and subtract it from the subtotal. Identify this adjustment as "U.S. Savings Bond Interest Previously Reported."

#### **Interest accrued on U.S. Treasury bonds.**

The interest accrued on U.S. Treasury bonds owned by a cash method taxpayer and redeemable for the payment of federal estate taxes that was not received as of the date of the individual's death is income in respect of the decedent. This interest is not included in the decedent's final income tax return. The estate will treat such interest as taxable income in the tax year received if it chooses to redeem the U.S. Treasury bonds to pay federal estate taxes. If the person entitled to the bonds (by bequest, devise, or inheritance, or because of the death of the individual) receives them, that person will treat the accrued interest as taxable income in the year the interest is received. Interest that accrues on the U.S. Treasury bonds after the owner's death does not represent income in respect of the decedent. The interest, however, is taxable income and must be included in the income of the respective recipients.

#### **Interest accrued on savings certificates.**

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

**Inherited IRAs.** If a beneficiary receives a lump-sum distribution from a traditional IRA he or she inherited, all or some of it may be taxable. The distribution is taxable in the year received as income in respect of a decedent up to the decedent's taxable balance. This is the decedent's balance at the time of death, including unrealized appreciation and income accrued to date of death, minus any basis (nondeductible contributions). Amounts distributed that are more than the decedent's entire IRA balance (includes taxable and nontaxable amounts) at the time of death are the income of the beneficiary.

If the beneficiary of a traditional IRA is the decedent's surviving spouse who properly rolls over the distribution into another traditional IRA, the distribution is not currently taxed. A surviving spouse also can roll over tax free the taxable part of the distribution into a qualified plan, section 403 annuity, or section 457 plan.

**Example 1.** At the time of his death, Greg owned a traditional IRA. All of the contributions by Greg to the IRA had been deductible contributions. Greg's nephew, Mark, was the sole beneficiary of the IRA. The entire balance of the IRA, including income accruing before and after Greg's death, was distributed to Mark in a lump sum. Mark must include the total amount received in his income. The portion of the lump-sum distribution that equals the amount of the balance in the IRA at Greg's death, including the income earned before death, is income in respect of the decedent. Mark may take a de-

duction for any federal estate taxes that were paid on that portion.

**Example 2.** Assume the same facts as in Example 1, except that some of Greg's contributions to the IRA had been nondeductible contributions. To determine the amount to include in income, Mark must subtract the total nondeductible contributions made by Greg from the total amount received (including the income that was earned in the IRA both before and after Greg's death). Income in respect of the decedent is the total amount included in income less the income earned after Greg's death.

For more information on inherited IRAs, see Publication 590.

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



*A distribution cannot be a qualified distribution unless it is made after 2002.*

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

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

For more information on Roth IRAs, see Publication 590.

**Coverdell education savings account (ESA).** Generally, the balance in a Coverdell ESA must be distributed within 30 days after the individual for whom the account was established reaches age 30 or dies, whichever is earlier. The treatment of the Coverdell ESA at the death of an individual under age 30 depends on who acquires the interest in the account. If the decedent's estate acquires the interest, see the discussion under *Final Return for Decedent*, earlier.



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

If the decedent's spouse or other family member is the designated beneficiary of the decedent's account, the Coverdell ESA be-

comes that person's Coverdell ESA. It is subject to the rules discussed in Publication 970.

Any other beneficiary (including a spouse or family member who is not the designated beneficiary) must include in income the earnings portion of the distribution. Any balance remaining at the close of the 30-day period is deemed to be distributed at that time. The amount included in income is reduced by any qualified education expenses of the decedent that are paid by the beneficiary within 1 year after the decedent's date of death. An estate tax deduction, discussed later, applies to the amount included in income by a beneficiary other than the decedent's spouse or family member.

**Archer MSA.** The treatment of an Archer MSA or a Medicare+Choice MSA, at the death of the account holder depends on who acquires the interest in the account. If the decedent's estate acquired the interest, see the discussion under *Final Return for Decedent*, earlier.

If the decedent's spouse is the designated beneficiary of the account, the account becomes that spouse's Archer MSA. It is subject to the rules discussed in Publication 969.

Any other beneficiary (including a spouse that is not the designated beneficiary) must include in income the fair market value of the assets in the account on the decedent's date of death. This amount must be reported for the beneficiary's tax year that includes the decedent's date of death. The amount included in income is reduced by any qualified medical expenses for the decedent that are paid by the beneficiary within 1 year after the decedent's date of death. An estate tax deduction, discussed later, applies to the amount included in income by a beneficiary other than the decedent's spouse.

## Deductions in Respect of the Decedent

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

- The estate.
- The person who acquired an interest in the decedent's property (subject to such obligations) because of the decedent's death, if the estate was not liable for the obligation.

Similar treatment is given to the foreign tax credit. A beneficiary who must pay a foreign tax on income in respect of a decedent will be entitled to claim the foreign tax credit.

**Depletion.** The deduction for percentage depletion is allowable only to the person (estate or beneficiary) who receives income in respect of the decedent to which the deduction relates, whether or not that person receives the property from which the income is derived. An heir who (because of the decedent's death) receives income as a result of the sale of units of mineral by the decedent (who used the cash method) will be entitled to the depletion allowance for that income. If the decedent had not figured the deduction on the basis of percentage depletion,

any depletion deduction to which the decedent was entitled at the time of death would be allowable on the decedent's final return, and no depletion deduction in respect of the decedent would be allowed to anyone else.

For more information about depletion, see chapter 10 in Publication 535, *Business Expenses*.

## Estate Tax Deduction

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

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

Individuals can claim this deduction only as an itemized deduction, on line 27 of Schedule A (Form 1040). This deduction is **not** subject to the 2% limit on miscellaneous itemized deductions. Estates can claim the deduction on the line provided for the deduction on Form 1041. For the alternative minimum tax computation, the deduction is not included in the itemized deductions that are an adjustment to taxable income.

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

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

## Computation

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

- The estate tax that qualifies for the deduction, and
- The recipient's part of the deductible tax.

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

**Example 1.** Jack Sage used the cash method of accounting. At the time of his death, he was entitled to receive \$12,000 from clients for his services and he had accrued bond interest of \$8,000, for a total income in respect of the decedent of \$20,000. He also owed \$5,000 for business expenses for which his estate is liable. The income and expenses are reported on Jack's estate tax return.



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

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

**Example 2.** As the beneficiary of Jack's estate (*Example 1*), you collect the \$12,000 accounts receivable from his clients. You will include the \$12,000 in your income in the tax year you receive it. If you itemize your deductions in that tax year, you can claim an estate tax deduction of \$2,772 figured as follows:

Value included in your income	X	Estate tax qualifying for deduction		
Total value of income in respect of decedent			X	=
\$12,000			\$4,620	=
\$20,000				\$2,772

If the amount you collected for the accounts receivable was more than \$12,000, you would still claim \$2,772 as an estate tax deduction because only the \$12,000 actually reported on the estate tax return can be used in the above computation. However, if you collected less than the \$12,000 reported on the estate tax return, use the smaller amount to figure the estate tax deduction.

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

**Surviving annuities.** For the estate tax deduction, an annuity received by a surviving annuitant under a joint and survivor annuity contract is considered income in respect of a decedent. The deceased annuitant must have died after the annuity starting date. You must make a special computation to figure the estate tax deduction for the surviving annuitant. See section 1.691(d)-1 of the regulations.

## Gifts, Insurance, and Inheritances

Property received as a gift, bequest, or inheritance is not included in your income. However, if property you receive in this manner later produces income, such as interest, dividends, or

rents, that income is taxable to you. The income from property donated to a trust that is paid, credited, or distributed to you is taxable income to you. If the gift, bequest, or inheritance is the income from property, that income is taxable to you.

If you receive property from a decedent's estate in satisfaction of your right to the income of the estate, it is treated as a bequest or inheritance of income from property. See *Distributions to Beneficiaries From an Estate*, later.

## Insurance

The proceeds from a decedent's life insurance policy paid by reason of his or her death generally are excluded from income. The exclusion applies to any beneficiary, whether a family member or other individual, a corporation, or a partnership.

**Veterans' insurance proceeds.** Veterans' insurance proceeds and dividends are not taxable either to the veteran or to the beneficiaries.

Interest on dividends left on deposit with the Department of Veterans Affairs is not taxable.

**Life insurance proceeds.** Life insurance proceeds paid to you because of the death of the insured (or because the insured is a member of the U.S. uniformed services who is missing in action) are not taxable unless the policy was turned over to you for a price. This is true even if the proceeds are paid under an accident or health insurance policy or an endowment contract. If the proceeds are received in installments, see the discussion under *Insurance received in installments*, later.

**Accelerated death benefits.** You can exclude from income accelerated death benefits you receive on the life of an insured individual if certain requirements are met. Accelerated death benefits are amounts received under a life insurance contract before the death of the insured. These benefits also include amounts received on the sale or assignment of the contract to a viatical settlement provider. This exclusion applies only if the insured was a terminally ill individual or a chronically ill individual. This exclusion does not apply if the insured is a director, officer, employee, or has a financial interest, in any trade or business carried on by you.

**Terminally ill individual.** A terminally ill individual is one who has been certified by a physician as having an illness or physical condition that reasonably can be expected to result in death in 24 months or less from the date of certification.

**Chronically ill individual.** A chronically ill individual is one who has been certified as one of the following.

- An individual who, for at least 90 days, is unable to perform at least two activities of daily living without substantial assistance due to a loss of functional capacity.
- An individual who requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

A certification must have been made by a licensed health care practitioner within the previous 12 months.

**Exclusion limited.** If the insured was a chronically ill individual, your exclusion of accelerated death benefits is limited to the cost you incurred in providing qualified long-term care services for the insured. In determining the cost incurred, do not include amounts paid or reimbursed by insurance or otherwise. Subject to certain limits, you can exclude payments received on a periodic basis without regard to your costs.

**Insurance received in installments.** If you receive life insurance proceeds in installments, you can exclude part of each installment from your income.

To determine the part excluded, divide the amount held by the insurance company (generally the total lump sum payable at the death of the insured person) by the number of installments to be paid. Include anything over this excluded part in your income as interest.

**Specified number of installments.** If you will receive a specified number of installments under the insurance contract, figure the part of each installment you can exclude by dividing the amount held by the insurance company by the number of installments to which you are entitled. A secondary beneficiary, in case you die before you receive all of the installments, is entitled to the same exclusion.

**Example.** As beneficiary, you choose to receive \$40,000 of life insurance proceeds in 10 annual installments of \$6,000. Each year, you can exclude from your income \$4,000 (\$40,000 ÷ 10) as a return of principal. The balance of the installment, \$2,000, is taxable as interest income.

**Specified amount payable.** If each installment you receive under the insurance contract is a specific amount based on a guaranteed rate of interest, but the number of installments you will receive is uncertain, the part of each installment that you can exclude from income is the amount held by the insurance company divided by the number of installments necessary to use up the principal and guaranteed interest in the contract.

**Example.** The face amount of the policy is \$200,000, and as beneficiary you choose to receive annual installments of \$12,000. The insurer's settlement option guarantees you this amount for 20 years based on a guaranteed rate of interest. It also provides that extra interest may be credited to the principal balance according to the insurer's earnings. The excludable part of each guaranteed installment is \$10,000 (\$200,000 ÷ 20 years). The balance of each guaranteed installment, \$2,000, is interest income to you. The full amount of any additional payment for interest is income to you.

**Installments for life.** If, as the beneficiary under an insurance contract, you are entitled to receive the proceeds in installments for the rest of your life without a refund or period-certain guarantee, you figure the excluded part of each installment by dividing the amount held by the insurance company by your life expectancy. If there is a refund or period-certain guarantee, the

amount held by the insurance company for this purpose is reduced by the actuarial value of the guarantee.

**Example.** As beneficiary, you choose to receive the \$50,000 proceeds from a life insurance contract under a life-income-with-cash-refund option. You are guaranteed \$2,700 a year for the rest of your life (which is estimated by use of mortality tables to be 25 years from the insured's death). The actuarial value of the refund feature is \$9,000. The amount held by the insurance company, reduced by the value of the guarantee, is \$41,000 (\$50,000 – \$9,000) and the excludable part of each installment representing a return of principal is \$1,640 (\$41,000 ÷ 25). The remaining \$1,060 (\$2,700 – \$1,640) is interest income to you. If you should die before receiving the entire \$50,000, the refund payable to the refund beneficiary is not taxable.

**Interest option on insurance.** If an insurance company pays you interest only on proceeds from life insurance left on deposit, the interest you are paid is taxable.

**Flexible premium contracts.** A life insurance contract (including any qualified additional benefits) is a flexible premium life insurance contract if it provides for the payment of one or more premiums that are not fixed by the insurer as to both timing and amount. For a flexible premium contract issued before January 1, 1985, the proceeds paid under the contract because of the death of the insured will be excluded from the recipient's income only if the contract meets the requirements explained under section 101(f) of the Internal Revenue Code.

## Basis of Inherited Property

Your basis in property you inherit from a decedent is generally one of the following.

- The fair market value (FMV) of the property at the date of the individual's death.
- The FMV on the alternate valuation date (discussed in the instructions for Form 706), if so elected by the personal representative for the estate.
- The value under the special-use valuation method for real property used in farming or other closely held business (see *Special-use valuation*, later), if so elected by the personal representative.
- The decedent's adjusted basis in land to the extent of the value that is excluded from the decedent's taxable estate as a qualified conservation easement (discussed in the instructions for Form 706).

**Exception for appreciated property.** If you or your spouse gave **appreciated property** to an individual during the 1-year period ending on the date of that individual's death and you (or your spouse) later acquired the same property from the decedent, your basis in the property is the same as the decedent's adjusted basis immediately before death.

**Appreciated property.** Appreciated property is property that had an FMV greater than its

adjusted basis on the day it was transferred to the decedent.

**Special-use valuation.** If you are a **qualified heir** and you receive a **farm or other closely held business real property** from the estate for which the personal representative elected special-use valuation, the property is valued on the basis of its actual use rather than its FMV.

If you are a qualified heir and you buy special-use valuation property from the estate, your basis is the estate's basis (determined under the special-use valuation method) immediately before your purchase increased by any gain recognized by the estate.

You are a **qualified heir** if you are an ancestor (parent, grandparent, etc.), the spouse, or a lineal descendant (child, grandchild, etc.) of the decedent, a lineal descendant of the decedent's parent or spouse, or the spouse of any of these lineal descendants.

For more information on special-use valuation, see Form 706.

**Increased basis for special-use valuation property.** Under certain conditions, some or all of the estate tax benefits obtained by using the special-use valuation will be subject to recapture. Generally, an additional estate tax must be paid by the qualified heir if within 10 years of the decedent's death the property is disposed of, or is no longer used for a qualifying purpose.

If you must pay any additional estate (recapture) tax, you can elect to increase your basis in the special-use valuation property to its FMV on the date of the decedent's death (or on the alternate valuation date, if it was elected by the personal representative). If you elect to increase your basis, you must pay interest on the recapture tax for the period from the date 9 months after the decedent's death until the date you pay the recapture tax.

For more information on the recapture tax, see *Instructions for Form 706*–A.

**S corporation stock.** The basis of inherited S corporation stock must be reduced if there is income in respect of a decedent attributable to that stock.

**Joint interest.** Figure the surviving tenant's new basis of property that was jointly owned (joint tenancy or tenancy by the entirety) by adding the surviving tenant's original basis in the property to the value of the part of the property (one of the values described earlier) included in the decedent's estate. Subtract from the sum any deductions for wear and tear, such as depreciation or depletion, allowed to the surviving tenant on that property.

**Example.** Fred and Anne Maple (brother and sister) owned, as joint tenants with right of survivorship, rental property they purchased for \$60,000. Anne paid \$15,000 of the purchase price and Fred paid \$45,000. Under local law, each had a half interest in the income from the property. When Fred died, the FMV of the property was \$100,000. Depreciation deductions allowed before Fred's death were \$20,000. Anne's basis in the property is \$80,000 figured as follows:

Anne's original basis . . . . .	\$15,000	
Interest acquired from Fred (3/4 of \$100,000) . . . . .	<u>75,000</u>	\$90,000

Minus: 1/2 of \$20,000 depreciation . . . . .	<u>10,000</u>	
<b>Anne's basis . . . . .</b>		<b>\$80,000</b>

**Qualified joint interest.** One-half of the value of property owned by a decedent and spouse as tenants by the entirety, or as joint tenants with right of survivorship if the decedent and spouse are the only joint tenants, is included in the decedent's gross estate. This is true regardless of how much each contributed toward the purchase price.

Figure the basis for a surviving spouse by adding one-half of the property's cost basis to the value included in the gross estate. Subtract from this sum any deductions for wear and tear, such as depreciation or depletion, allowed on that property to the surviving spouse.

**Example.** Dan and Diane Gilbert owned, as tenants by the entirety, rental property they purchased for \$60,000. Dan paid \$15,000 of the purchase price and Diane paid \$45,000. Under local law, each had a half interest in the income from the property. When Diane died, the FMV of the property was \$100,000. Depreciation deductions allowed before Diane's death were \$20,000. Dan's basis in the property is \$70,000 figured as follows:

One-half of cost basis (1/2 of \$60,000) . . . . .	\$30,000	
Interest acquired from Diane (1/2 of \$100,000) . . . . .	<u>50,000</u>	\$80,000
Minus: 1/2 of \$20,000 depreciation . . . . .	<u>10,000</u>	
<b>Dan's basis . . . . .</b>		<b>\$70,000</b>

**More information.** See Publication 551, *Basis of Assets*, for more information on basis. If you and your spouse lived in a community property state, see the discussion in that publication about figuring the basis of your community property after your spouse's death.

**Depreciation.** If you can depreciate property you inherited, you generally must use the modified accelerated cost recovery system (MACRS) to determine depreciation.

For joint interests and qualified joint interests, you must make the following computations to figure depreciation.

- The first computation is for your original basis in the property.
- The second computation is for the inherited part of the property.

Continue depreciating your original basis under the same method you had used in previous years. Depreciate the inherited part using MACRS.

MACRS consists of two depreciation systems, the General Depreciation System (GDS) and the Alternative Depreciation System (ADS). For more information on MACRS, see Publication 946, *How To Depreciate Property*.

**Substantial valuation misstatement.** If the value or adjusted basis of any property claimed on an income tax return is 200% or more of the amount determined to be the correct amount, there is a substantial valuation misstatement. If this misstatement results in an underpayment of tax of more than \$5,000, an addition to tax of 20% of the underpayment can apply. The penalty increases to 40% if the value or adjusted basis is 400% or more of the amount determined to be the correct amount. If the value shown on

the estate tax return is overstated and you use that value as your basis in the inherited property, you could be liable for the addition to tax.

The IRS may waive all or part of the addition to tax if you have a reasonable basis for the claimed value. The fact that the adjusted basis on your income tax return is the same as the value on the estate tax return is not enough to show that you had a reasonable basis to claim the valuation.

**Holding period.** If you sell or dispose of inherited property that is a capital asset, you have a long-term gain or loss from property held for more than 1 year, regardless of how long you held the property.

**Property distributed in kind.** Your basis in property distributed in kind by a decedent's estate is the same as the estate's basis immediately before the distribution plus any gain, or minus any loss, recognized by the estate. Property is distributed in kind if it satisfies your right to receive another property or amount, such as the income of the estate or a specific dollar amount. Property distributed in kind generally includes any noncash property you receive from the estate other than the following.

- A specific bequest (unless it must be distributed in more than three installments).
- Real property, the title to which passes directly to you under local law.

For information on an estate's recognized gain or loss on distributions in kind, see *Income To Include under Income Tax Return of an Estate—Form 1041*, later.

## Other Items of Income

Some other items of income that you, as a survivor or beneficiary, may receive are discussed below. Lump-sum payments you receive as the surviving spouse or beneficiary of a deceased employee may represent accrued salary payments; distributions from employee profit-sharing, pension, annuity, and stock bonus plans; or other items that should be treated separately for tax purposes. The treatment of these lump-sum payments depends on what the payments represent.



If the decedent is a specified terrorist victim (see Important Reminders), certain income received by the beneficiary or the estate is not included in income. See Publication 3920.

**Public safety officers.** Special rules apply to certain amounts received because of the death of a public safety officer (law enforcement officers, fire fighters, chaplains, ambulance crews, and rescue squads).



The provisions apply to a chaplain killed in the line of duty after September 10, 2001. The chaplain must have been responding to a fire, rescue, or police emergency as a member or employee of a fire or police department.

**Death benefits.** The death benefit payable to eligible survivors of public safety officers who die as a result of traumatic injuries sustained in the line of duty is not included in either the beneficiaries' income or the decedent's gross

estate. The benefit is administered through the Bureau of Justice Assistance (BJA).

The BJA can pay the eligible survivors an emergency interim benefit up to \$3,000 if it determines that a public safety officer's death is one for which a death benefit will probably be paid. If there is no final payment, the recipient of the interim benefit is liable for repayment. However, the BJA may waive all or part of the repayment if it will cause a hardship. If all or part of the repayment is waived, that amount is not included in income.

**Survivor benefits.** Generally, a survivor annuity received by the spouse, former spouse, or child of a public safety officer killed in the line of duty is excluded from the recipient's income. The annuity must be provided under a government plan and is excludable to the extent that it is attributable to the officer's service as a public safety officer.

The exclusion does not apply if the recipient's actions were responsible for the officer's death. It also does not apply in the following circumstances.

- The death was caused by the intentional misconduct of the officer or by the officer's intention to cause such death.
- The officer was voluntarily intoxicated at the time of death.
- The officer was performing his or her duties in a grossly negligent manner at the time of death.

**Salary or wages.** Salary or wages paid after the employee's death are usually taxable income to the beneficiary. See *Wages*, earlier, under *Specific Types of Income in Respect of a Decedent*.

**Rollover distributions.** An employee's surviving spouse who receives an eligible rollover distribution may roll it over tax free into an IRA, a qualified plan, a section 403 annuity, or a section 457 plan. A distribution to a beneficiary other than the employee's surviving spouse is not an eligible rollover distribution and is subject to tax. If the decedent was born before 1936, the beneficiary may be able to use optional methods to figure the tax on the distribution. For more information, see Publication 575, *Pension and Annuity Income*.

**Pensions and annuities.** For beneficiaries who receive pensions and annuities, see Publication 575. For beneficiaries of federal Civil Service employees or retirees, see Publication 721, *Tax Guide to U.S. Civil Service Retirement Benefits*.

**Inherited IRAs.** If a person other than the decedent's spouse inherits the decedent's traditional IRA or Roth IRA, that person cannot treat the IRA as one established on his or her behalf. If a distribution from a traditional IRA is from contributions that were deducted or from earnings and gains in the IRA, it is fully taxable income. If there were nondeductible contributions, an allocation between taxable and nontaxable income must be made. For information on distributions from a Roth IRA, see the discussion earlier under *Income in Respect of the Decedent*. The inherited IRA cannot be rolled over into, or receive a rollover from, another IRA. No deduction is allowed for amounts paid into

that inherited IRA. For more information about IRAs, see Publication 590.

**Estate income.** Estates may have to pay federal income tax. Beneficiaries may have to pay tax on their share of estate income. However, there is never a double tax. See *Distributions to Beneficiaries From an Estate*, later.

## Income Tax Return of an Estate—Form 1041

An estate is a taxable entity separate from the decedent and comes into being with the death of the individual. It exists until the final distribution of its assets to the heirs and other beneficiaries. The income earned by the assets during this period must be reported by the estate under the conditions described in this publication. The tax generally is figured in the same manner and on the same basis as for individuals, with certain differences in the computation of deductions and credits, as explained later.

The estate's income, like an individual's income, must be reported annually on either a calendar or fiscal year basis. As the personal representative, you choose the estate's accounting period when you file its first Form 1041. The estate's first tax year can be any period that ends on the last day of a month and does not exceed 12 months.

Once you choose the tax year, you generally cannot change it without IRS approval. Also, on the first income tax return, you must choose the accounting method (cash, accrual, or other) you will use to report the estate's income. Once you have used a method, you ordinarily cannot change it without IRS approval. For a more complete discussion of accounting periods and methods, see Publication 538, *Accounting Periods and Methods*.

## Filing Requirements

Every domestic estate with gross income of \$600 or more during a tax year must file a Form 1041. If one or more of the beneficiaries of the domestic estate are nonresident alien individuals, the personal representative must file Form 1041, even if the gross income of the estate is less than \$600.

A fiduciary for a nonresident alien estate with U.S. source income, including any income that is effectively connected with the conduct of a trade or business in the United States, must file **Form 1040NR, U.S. Nonresident Alien Income Tax Return**, as the income tax return of the estate.

A nonresident alien who was a **resident of Puerto Rico, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands** for the entire tax year will, for this purpose, be treated as a resident alien of the United States.

## Schedule K-1 (Form 1041)

As personal representative, you must file a separate Schedule K-1 (Form 1041), or an accept-



able substitute (described below), for each beneficiary. File these schedules with Form 1041.

You must show each beneficiary's taxpayer identification number. A \$50 penalty is charged for each failure to provide the identifying number of each beneficiary unless reasonable cause is established for not providing it. When you assume your duties as the personal representative, you must ask each beneficiary to give you a taxpayer identification number (TIN). A nonresident alien beneficiary that gives you a withholding certificate generally must provide you with a TIN (see Publication 515, *Withholding of Tax on Nonresident Aliens and Foreign Entities*). A TIN is not required for an executor or administrator of the estate unless that person is also a beneficiary.

As personal representative, you must also furnish a Schedule K-1 (Form 1041), or a substitute, to the beneficiary by the date on which the Form 1041 is filed. Failure to provide this payee statement can result in a penalty of \$50 for each failure. This penalty also applies if you omit information or include incorrect information on the payee statement.

You do not need prior approval for a **substitute** Schedule K-1 (Form 1041) that is an exact copy of the official schedule or that follows the specifications in Publication 1167, *Substitute Printed, Computer-Prepared, and Computer-Generated Tax Forms and Schedules*. You must have prior approval for any other substitute Schedule K-1 (Form 1041).

**Beneficiaries.** The personal representative has a fiduciary responsibility to the ultimate recipients of the income and the property of the estate. While the courts use a number of names to designate specific types of beneficiaries or the recipients of various types of property, it is sufficient in this publication to call all of them beneficiaries.

**Liability of the beneficiary.** The income tax liability of an estate attaches to the assets of the estate. If the income is distributed or must be distributed during the current tax year, the income is reportable by each beneficiary on his or her individual income tax return. If the income does not have to be distributed, and is not distributed but is retained by the estate, the income tax on the income is payable by the estate. If the income is distributed later without the payment of the taxes due, the beneficiary can be liable for tax due and unpaid to the extent of the value of the estate assets received.

Income of the estate is taxed to either the estate or the beneficiary, but not to both.

**Nonresident alien beneficiary.** As a resident or domestic fiduciary, in addition to filing Form 1041, you may have to file the income tax return (Form 1040NR) and pay the tax for a nonresident alien beneficiary. Depending upon a number of factors, you may or may not have to file Form 1040NR for that beneficiary. For information on who must file Form 1040NR, see Publication 519, *U.S. Tax Guide for Aliens*.

You do not have to file the nonresident alien's return and pay the tax if that beneficiary has appointed an agent in the United States to file a federal income tax return. However, you must attach to the estate's return (Form 1041) a copy of the document that appoints the beneficiary's agent.

You also must file Form 1042, *Annual Withholding Tax Return for U.S. Source Income of Foreign Persons*, and Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding*, to report and transmit withheld tax on distributable net income (discussed later) actually distributed. This applies to the extent the distribution consists of an amount subject to withholding. For more information, see Publication 515.

## Amended Return

If you have to file an amended Form 1041, use a copy of the form for the appropriate year and check the Amended return box. Complete the entire return, correct the appropriate lines with the new information, and refigure the tax liability. On an attached sheet, explain the reason for the changes and identify the lines and amounts changed.

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, you must file an amended Schedule K-1 (Form 1041) and give a copy to each beneficiary. Check the Amended K-1 box at the top of Schedule K-1.

## Information Returns

Even though you may not have to file an income tax return for the estate, you may have to file Form 1099-DIV, Form 1099-INT, or Form 1099-MISC, if you receive the income as a nominee or middleman for another person. For more information on filing information returns, see the *General Instructions for Forms 1099, 1098, 5498, and W-2G*.

You will not have to file information returns for the estate if the estate is the owner of record and you file an income tax return for the estate on Form 1041 giving the name, address, and identifying number of each actual owner and furnish a completed Schedule K-1 (Form 1041) to each actual owner.

**Penalty.** A penalty of up to \$50 can be charged for each failure to file or failure to include correct information on an information return. (Failure to include correct information includes failure to include all the information required.) If it is shown that such failure is due to intentional disregard of the filing requirement, the penalty amount increases.

See the *General Instructions for Forms 1099, 1098, 5498, and W-2G* for more information.

## Two or More Personal Representatives

If property is located outside the state in which the decedent's home was located, more than one personal representative may be designated by the will or appointed by the court. The person designated or appointed to administer the estate in the state of the decedent's permanent home is called the **domiciliary representative**. The person designated or appointed to administer property in a state other than that of the decedent's permanent home is called an **ancillary representative**.

**Separate Forms 1041.** Each representative must file a separate Form 1041. The domiciliary representative must include the estate's entire income in the return. The ancillary representative files with the appropriate IRS office for the ancillary's location. The ancillary representative should provide the following information on the return.

- The name and address of the domiciliary representative.
- The amount of gross income received by the ancillary representative.
- The deductions claimed against that income (including any income properly paid or credited by the ancillary representative to a beneficiary).

**Estate of a nonresident alien.** If the estate of a nonresident alien has a nonresident alien domiciliary representative and an ancillary representative who is a citizen or resident of the United States, the ancillary representative, in addition to filing a Form 1040NR to provide the information described in the preceding paragraph, must also file the return that the domiciliary representative otherwise would have to file.

## Copy of the Will

You do not have to file a copy of the decedent's will unless requested by the IRS. If requested, you must attach a statement to it indicating the provisions that, in your opinion, determine how much of the estate's income is taxable to the estate or to the beneficiaries. You should also attach a statement signed by you under penalties of perjury that the will is a true and complete copy.

## Income To Include

The estate's taxable income generally is figured the same way as an individual's income, except as explained in the following discussions.



*If the decedent is a specified terrorist victim (see Important Reminders), certain income received by the estate is not included in income. See the Form 1041 instructions and Publication 3920.*

Gross income of an estate consists of all items of income received or accrued during the tax year. It includes dividends, interest, rents, royalties, gain from the sale of property, and income from business, partnerships, trusts, and any other sources. For a discussion of income from dividends, interest, and other investment income as well as gains and losses from the sale of investment property, see Publication 550. For a discussion of gains and losses from the sale of other property, including business property, see Publication 544, *Sales and Other Dispositions of Assets*.

If, as the personal representative, your duties include the operation of the decedent's business, see Publication 334. That publication provides general information about the tax laws that apply to a sole proprietorship.

**Income in respect of the decedent.** As the personal representative of the estate, you may receive income that the decedent would have reported had death not occurred. For an expla-

nation of this income, see *Income in Respect of the Decedent* under *Other Tax Information*, earlier. An estate may qualify to claim a deduction for estate taxes if the estate must include in gross income for any tax year an amount of income in respect of a decedent. See *Estate Tax Deduction*, earlier, under *Other Tax Information*.

**Gain (or loss) from sale of property.** During the administration of the estate, you may find it necessary or desirable to sell all or part of the estate's assets to pay debts and expenses of administration, or to make proper distributions of the assets to the beneficiaries. While you may have the legal authority to dispose of the property, title to it may be vested (given a legal interest in the property) in one or more of the beneficiaries. This is usually true of real property. To determine whether any gain or loss must be reported by the estate or by the beneficiaries, consult local law to determine the legal owner.

**Redemption of stock to pay death taxes.** Under certain conditions, a distribution to a shareholder (including the estate) in redemption of stock that was included in the decedent's gross estate may be allowed capital gain (or loss) treatment.

**Character of asset.** The character of an asset in the hands of an estate determines whether gain or loss on its sale or other disposition is capital or ordinary. The asset's character depends on how the estate holds or uses it. If it was a capital asset to the decedent, it generally will be a capital asset to the estate. If it was land or depreciable property used in the decedent's business and the estate continues the business, it generally will have the same character to the estate that it had in the decedent's hands. If it was held by the decedent for sale to customers, it generally will be considered to be held for sale to customers by the estate if the decedent's business continues to operate during the administration of the estate.



*An estate and a beneficiary of that estate are generally treated as related persons for purposes of treating the gain on the sale of depreciable property between the parties as ordinary income. This does not apply to a sale or exchange made to satisfy a pecuniary bequest.*

**Holding period.** An estate (or other recipient) that acquires a capital asset from a decedent and sells or otherwise disposes of it is considered to have held that asset for more than 1 year, regardless of how long the asset is held.

**Basis of asset.** The basis used to figure gain or loss for property the estate receives from the decedent usually is its fair market value at the date of death. See *Basis of Inherited Property* under *Other Tax Information*, earlier, for other basis in inherited property.

If the estate purchases property after the decedent's death, the basis generally will be its cost.

The basis of certain appreciated property the estate receives from the decedent will be the decedent's adjusted basis in the property immediately before death. This applies if the property was acquired by the decedent as a gift during the 1-year period before death, the property's fair market value on the date of the gift was

greater than the donor's adjusted basis, and the proceeds of the sale of the property are distributed to the donor (or the donor's spouse).

**Schedule D (Form 1041).** To report gains (and losses) from the sale or exchange of capital assets by the estate, file Schedule D (Form 1041), *Capital Gains and Losses*, with Form 1041. For additional information about the treatment of capital gains and losses, see the instructions for Schedule D (Form 1041).

**Installment obligations.** If an installment obligation owned by the decedent is transferred by the estate to the obligor (buyer or person obligated to pay) or is canceled at death, include the income from that event in the gross income of the estate. See *Installment obligations* under *Income in Respect of the Decedent*, earlier. See Publication 537 for information about installment sales.

**Gain from sale of special-use valuation property.** If you elected special-use valuation for farm or other closely held business real property and that property is sold to a **qualified heir**, the estate will recognize gain on the sale if the fair market value on the date of the sale exceeds the fair market value on the date of the decedent's death (or on the alternate valuation date if it was elected).

**Qualified heirs.** Qualified heirs include the decedent's ancestors (parents, grandparents, etc.) and spouse, the decedent's lineal descendants (children, grandchildren, etc.) and their spouses, and lineal descendants (and their spouses) of the decedent's parents or spouse.

For more information about special-use valuation, see Form 706 and its instructions.

**Gain from transfer of property to a political organization.** Appreciated property that is transferred to a political organization is treated as sold by the estate. Appreciated property is property that has a fair market value (on the date of the transfer) greater than the estate's basis. The gain recognized is the difference between the estate's basis and the fair market value on the date transferred.

A political organization is any party, committee, association, fund, or other organization formed and operated to accept contributions or make expenditures for influencing the nomination, election, or appointment of an individual to any federal, state, or local public office.

**Gain or loss on distributions in kind.** An estate recognizes gain or loss on a distribution of property in kind to a beneficiary only in the following situations.

- 1) The distribution satisfies the beneficiary's right to receive either—
  - a) A specific dollar amount (whether payable in cash, in unspecified property, or in both), or
  - b) A specific property other than the property distributed.
- 2) You choose to recognize the gain or loss on the estate's income tax return (section 643(e)(3) election).

The gain or loss is usually the difference between the fair market value of the property when distributed and the estate's basis in the

property. However, see *Gain from sale of special-use valuation property*, earlier, for a limit on the gain recognized on a transfer of such property to a qualified heir.

If you choose to recognize gain or loss, the choice applies to all noncash distributions during the tax year except charitable distributions and specific bequests. To make the choice, report the transaction on Schedule D (Form 1041) attached to the estate's Form 1041 and check the box on line 7 in the *Other Information* section of Form 1041. You must make the choice by the due date (including extensions) of the estate's income tax return for the year of distribution. However, if you timely filed your return for the year without making the choice, you can still make the choice by filing an amended return within six months of the due date of the return (excluding extensions). Attach Schedule D (Form 1041) to the amended return and write "Filed pursuant to section 301.9100-2" on the form. File the amended return at the same address you filed the original return. You must get the consent of the IRS to revoke the choice.

For more information, see *Property distributed in kind* under *Distributions Deduction*, later.



*Under the related persons rules, you cannot claim a loss for property distributed to a beneficiary unless the distribution is in discharge of a pecuniary bequest. Also, any gain on the distribution of depreciable property is ordinary income.*

## Exemption and Deductions

In figuring taxable income, an estate is generally allowed the same deductions as an individual. Special rules, however, apply to some deductions for an estate. This section includes discussions of those deductions affected by the special rules.

### Exemption Deduction

An estate is allowed an exemption deduction of \$600 in figuring its taxable income. No exemption for dependents is allowed to an estate. Even though the first return of an estate may be for a period of less than 12 months, the exemption is \$600. If, however, the estate was given permission to change its accounting period, the exemption is \$50 for each month of the short year.

### Contributions

An estate qualifies for a deduction for amounts of gross income paid or permanently set aside for qualified charitable organizations. The adjusted gross income limits for individuals do not apply. However, to be deductible by an estate, the contribution must be specifically provided for in the decedent's will. If there is no will, or if the will makes no provision for the payment to a charitable organization, then a deduction will not be allowed even though all of the beneficiaries may agree to the gift.

You cannot deduct any contribution from income that is not included in the estate's gross income. If the will specifically provides that the contributions are to be paid out of the estate's gross income, the contributions are fully deducti-

ble. However, if the will contains no specific provisions, the contributions are considered to have been paid and are deductible in the same proportion as the gross income bears to the total of all classes (taxable and nontaxable) of income.

You cannot deduct a qualified conservation easement granted after the date of death and before the due date of the estate tax return. A contribution deduction is allowed to the estate for estate tax purposes.

For more information about contributions, see Publication 526, *Charitable Contributions*, and Publication 561, *Determining the Value of Donated Property*.

## Losses

Generally, an estate can claim a deduction for a loss that it sustains on the sale of property. This includes a loss from the sale of property (other than stock) to a personal representative of the estate, unless that person is a beneficiary of the estate.

For a discussion of an estate's recognized loss on a distribution of property in kind to a beneficiary, see *Income To Include*, earlier.



*An estate and a beneficiary of that estate are generally treated as related persons for purposes of the disallowance of a loss on the sale of an asset between related persons. The disallowance does not apply to a sale or exchange made to satisfy a pecuniary bequest.*

**Net operating loss deduction.** An estate can claim a net operating loss deduction, figured in the same way as an individual's, except that it cannot deduct any distributions to beneficiaries (discussed later) or the deduction for charitable contributions in figuring the loss or the loss carryover. For a discussion of the carryover of an unused net operating loss to a beneficiary upon termination of the estate, see *Termination of Estate*, later.

For information on net operating losses, see Publication 536.

**Casualty and theft losses.** Losses incurred for casualty and theft during the administration of the estate can be deducted only if they have not been claimed on the federal estate tax return (Form 706). You must file a statement with the estate's income tax return waiving the deduction for estate tax purposes. See *Administration Expenses*, later.

The same rules that apply to individuals apply to the estate, except that in figuring the adjusted gross income of the estate used to figure the deductible loss, you deduct any administration expenses claimed. Use Form 4684, *Casualties and Thefts*, and its instructions to figure any loss deduction.

**Carryover losses.** Carryover losses resulting from net operating losses or capital losses sustained by the decedent **before death** cannot be deducted on the estate's income tax return.

## Administration Expenses

Expenses of administering an estate can be deducted either from the gross estate in figuring the federal estate tax on Form 706 or from the

estate's gross income in figuring the estate's income tax on Form 1041. However, these expenses cannot be claimed for **both** estate tax and income tax purposes. In most cases, this rule also applies to expenses incurred in the sale of property by an estate (not as a dealer).

To prevent a double deduction, amounts otherwise allowable in figuring the decedent's taxable estate for federal estate tax on Form 706 will not be allowed as a deduction in figuring the income tax of the estate or of any other person unless the personal representative files a statement, in duplicate, that the items of expense, as listed in the statement, have not been claimed as deductions for federal estate tax purposes and that all rights to claim such deductions are **waived**. One deduction or part of a deduction can be claimed for income tax purposes if the appropriate statement is filed, while another deduction or part is claimed for estate tax purposes. Claiming a deduction in figuring the estate income tax is not prevented when the same deduction is claimed on the estate tax return so long as the estate tax deduction is not finally allowed and the preceding statement is filed. The statement can be filed with the income tax return or at any time before the expiration of the statute of limitations that applies to the tax year for which the deduction is sought. This waiver procedure also applies to casualty losses incurred during administration of the estate.

**Accrued expenses.** The rules preventing double deductions do not apply to deductions for taxes, interest, business expenses, and other items accrued at the date of death. These expenses are allowable as a deduction for estate tax purposes as claims against the estate and also are allowable as deductions in respect of a decedent for income tax purposes. Deductions for interest, business expenses, and other items not accrued at the date of the decedent's death are allowable only as a deduction for administration expenses for both estate and income tax purposes and do not qualify for a double deduction.

**Expenses allocable to tax-exempt income.** When figuring the estate's taxable income on Form 1041, you cannot deduct administration expenses allocable to any of the estate's tax-exempt income. However, you can deduct these administration expenses when figuring the taxable estate for federal estate tax purposes on Form 706.

**Interest on estate tax.** Interest paid on installment payments of estate tax is not deductible for income or estate tax purposes.

## Depreciation and Depletion

The allowable deductions for depreciation and depletion that accrue after the decedent's death must be apportioned between the estate and the beneficiaries, depending on the income of the estate that is allocable to each.

**Example.** In 2002, the decedent's estate realized \$3,000 of business income during the administration of the estate. The personal representative distributed \$1,000 of the income to the decedent's son Ned and \$2,000 to another son, Bill. The allowable depreciation on the business property is \$300. Ned can take a deduction of \$100  $[(\$1,000 \div \$3,000) \times \$300]$ , and Bill can

take a deduction of \$200  $[(\$2,000 \div \$3,000) \times \$300]$ .

## Distributions Deduction

An estate is allowed a deduction for the tax year for any income that must be distributed currently and for other amounts that are properly paid, credited, or required to be distributed to beneficiaries. The deduction is limited to the **distributable net income** of the estate.

For special rules that apply in figuring the estate's distribution deduction, see *Bequest under Distributions to Beneficiaries From an Estate*, later.

**Distributable net income.** Distributable net income (determined on Schedule B of Form 1041) is the estate's income available for distribution. It is the estate's taxable income, with the following modifications.

**Distributions to beneficiaries.** Distributions to beneficiaries are not deducted.

**Estate tax deduction.** The deduction for estate tax on income in respect of the decedent is not allowed.

**Exemption deduction.** The exemption deduction is not allowed.

**Capital gains.** Capital gains ordinarily are not included in distributable net income. However, you include them in distributable net income if any of the following apply.

- The gain is allocated to income in the accounts of the estate or by notice to the beneficiaries under the terms of the will or by local law.
- The gain is allocated to the corpus or principal of the estate and is actually distributed to the beneficiaries during the tax year.
- The gain is used, under either the terms of the will or the practice of the personal representative, to determine the amount that is distributed or must be distributed.
- Charitable contributions are made out of capital gains.

Generally, when you determine capital gains to be included in distributable net income, the exclusion for gain from the sale or exchange of qualified small business stock is not taken into account.

**Capital losses.** Capital losses are excluded in figuring distributable net income unless they enter into the computation of any capital gain that is distributed or must be distributed during the year.

**Tax-exempt interest.** Tax-exempt interest, including exempt-interest dividends, though excluded from the estate's gross income, is included in the distributable net income, but is reduced by the following items.

- The expenses that were not allowed in computing the estate's taxable income because they were attributable to tax-exempt interest (see *Expenses allocable to tax-exempt income under Administration Expenses*, earlier).



- The part of the tax-exempt interest deemed to have been used to make a charitable contribution. See *Contributions*, earlier.

The total tax-exempt interest earned by an estate must be shown in the *Other Information* section of Form 1041. The beneficiary's part of the tax-exempt interest is shown on Schedule K-1 (Form 1041).

**Separate shares rule.** The separate shares rule must be used if both of the following are true.

- The estate has more than one beneficiary.
- The economic interest of a beneficiary does not affect and is not affected by the economic interest of another beneficiary.

A bequest of a specific sum of money or of property is not a separate share (see *Bequest*, later).

If the separate shares rule applies, the separate shares are treated as separate estates for the sole purpose of determining the distributable net income allocable to a share. Each share's distributable net income is based on that share's portion of gross income and any applicable deductions or losses. You must use a reasonable and equitable method to make the allocations.

Generally, gross income is allocated among the separate shares based on the income that each share is entitled to under the will or applicable local law. This includes gross income that is not received in cash, such as a distributive share of partnership tax items.

If a beneficiary is not entitled to any of the estate's income, the distributable net income for that beneficiary is zero. The estate cannot deduct any distribution made to that beneficiary and the beneficiary does not have to include the distribution in its gross income. However, see *Income in respect of a decedent*, later in this discussion.

**Example.** Patrick's will directs you, the executor, to distribute ABC Corporation stock and all dividends from that stock to his son, Edward, and the residue of the estate to his son, Michael. The estate has two separate shares consisting of the dividends on the stock left to Edward and the residue of the estate left to Michael. The distribution of the ABC Corporation stock qualifies as a bequest, so it is not a separate share.

If any distributions, other than the ABC Corporation stock, are made during the year to either Edward or Michael, you must determine the distributable net income for each separate share. The distributable net income for Edward's separate share includes only the dividends attributable to the ABC Corporation stock. The distributable net income for Michael's separate share includes all other income.

**Income in respect of a decedent.** This income is allocated among the separate shares that could potentially be funded with these amounts, even if the share is not entitled to receive any income under the will or applicable local law. This allocation is based on the relative value of each share that could potentially be funded with these amounts.

**Example 1.** Frank's will directs you, the executor, to divide the residue of his estate (valued

at \$900,000) equally between his two children, Judy and Ann. Under the will, you must fund Judy's share first with the proceeds of Frank's traditional IRA. The \$90,000 balance in the IRA was distributed to the estate during the year. This amount is included in the estate's gross income as income in respect of the decedent and is allocated to the corpus of the estate. The estate has two separate shares, one for the benefit of Judy and one for the benefit of Ann. If any distributions are made to either Judy or Ann during the year, then, for purposes of determining the distributable net income for each separate share, the \$90,000 of income in respect of the decedent must be allocated only to Judy's share.

**Example 2.** Assume the same facts as in Example 1, except that you must fund Judy's share first with DEF Corporation stock valued at \$300,000, rather than the IRA proceeds. To determine the distributable net income for each separate share, the \$90,000 of income in respect of the decedent must be allocated between the two shares to the extent they could potentially be funded with that income. The maximum amount of Judy's share that could be funded with that income is \$150,000 (\$450,000 value of share less \$300,000 funded with stock). The maximum amount of Ann's share that could be funded is \$450,000. Based on the relative values, Judy's distributable net income includes \$22,500 ( $\$150,000/\$600,000 \times \$90,000$ ) of the income in respect of the decedent and Ann's distributable net income includes \$67,500 ( $\$450,000/\$600,000 \times \$90,000$ ).

**Income that must be distributed currently.** The distributions deduction includes any amount of income that, under the terms of the decedent's will or by reason of local law, must be distributed currently. This includes an amount that may be paid out of income or corpus (such as an annuity) to the extent it is paid out of income for the tax year. The deduction is allowed to the estate even if the personal representative does not make the distribution until a later year or makes no distribution until the final settlement and termination of the estate.

**Support allowances.** The distribution deduction includes any support allowance that, under a court order or decree or local law, the estate must pay the decedent's surviving spouse or other dependent for a limited period during administration of the estate. The allowance is deductible as income that must be distributed currently or as any other amount paid, credited, or required to be distributed, as discussed next.

**Any other amount paid, credited, or required to be distributed.** Any other amount paid, credited, or required to be distributed is allowed as a deduction to the estate only in the year actually paid, credited, or distributed. If there is no specific requirement by local law or by the terms of the will that income earned by the estate during administration be distributed currently, a deduction for distributions to the beneficiaries will be allowed to the estate, but only for the actual distributions during the tax year.

If the personal representative has discretion as to when the income is distributed, the deduction is allowed only in the year of distribution.

The personal representative can elect to treat distributions paid or credited within 65 days after the close of the estate's tax year as having been paid or credited on the last day of that tax year. The election is made by completing line 6 in the *Other Information* section of Form 1041. If a tax return is not required, the election is made on a statement which is filed with the IRS office where the return would have been filed. The election is irrevocable for the tax year and is only effective for the year of the election.

**Alimony and separate maintenance.** Alimony and separate maintenance payments that must be included in the spouse's or former spouse's income may be deducted as income that must be distributed currently if they are paid, credited, or distributed out of the income of the estate for the tax year. That spouse or former spouse is treated as a beneficiary.

**Payment of beneficiary's obligations.** Any payment made by the estate to satisfy a legal obligation of any person is deductible as income that must be distributed currently or as any other amount paid, credited, or required to be distributed. This includes a payment made to satisfy the person's obligation under local law to support another person, such as the person's minor child. The person whose obligation is satisfied is treated as a beneficiary of the estate.

This does not apply to a payment made to satisfy a person's obligation to pay alimony or separate maintenance.

**Interest in real estate.** The value of an interest in real estate owned by a decedent, title to which passes directly to the beneficiaries under local law, is not included as any other amount paid, credited, or required to be distributed.

**Property distributed in kind.** If an estate distributes property in kind, the estate's deduction ordinarily is the lesser of its basis in the property or the property's fair market value when distributed. However, the deduction is the property's fair market value if the estate recognizes gain on the distribution. See *Gain or loss on distributions in kind* under *Income To Include*, earlier.

Property is distributed in kind if it satisfies the beneficiary's right to receive another property or amount, such as the income of the estate or a specific dollar amount. It generally includes any noncash distribution other than the following.

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

**Character of amounts distributed.** If the decedent's will or local law does not provide for the allocation of different classes of income, you must treat the amount deductible for distributions to beneficiaries as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income. For more information about the character of distributions, see *Character of Distributions* under *Distributions to Beneficiaries From an Estate*, later.

**Example.** An estate has distributable net income of \$2,000, consisting of \$1,000 of taxable interest and \$1,000 of rental income. Distribu-

tions to the beneficiary total \$1,500. The distribution deduction consists of \$750 of taxable interest and \$750 of rental income, unless the will or local law provides a different allocation.

**Limit on deduction for distributions.** You cannot deduct any amount of distributable net income not included in the estate's gross income.

**Example.** An estate has distributable net income of \$2,000, consisting of \$1,000 of dividends and \$1,000 of tax-exempt interest. Distributions to the beneficiary total \$1,500. Except for this rule, the distribution deduction would be \$1,500 (\$750 of dividends and \$750 of tax-exempt interest). However, as the result of this rule, the distribution deduction is limited to \$750, because no deduction is allowed for the tax-exempt interest distributed.

**Denial of double deduction.** A deduction cannot be claimed twice. If an amount is considered to have been distributed to a beneficiary of an estate in a preceding tax year, it cannot again be included in figuring the deduction for the year of the actual distribution.

**Example.** The will provides that the estate must distribute currently all of its income to a beneficiary. For administrative convenience, the personal representative did not make a distribution of a part of the income for the tax year until the first month of the next tax year. The amount must be deducted by the estate in the first tax year, and must be included in the income of the beneficiary in that year. This amount cannot be deducted again by the estate in the following year when it is paid to the beneficiary, nor must the beneficiary again include the amount in income in that year.

**Charitable contribution.** The amount of a charitable contribution used as a deduction by the estate in determining taxable income cannot be claimed again as a deduction for a distribution to a beneficiary.

## Funeral and Medical Expenses

No deduction can be taken for funeral expenses or medical and dental expenses on the estate's income tax return, Form 1041.

**Funeral expenses.** Funeral expenses paid by the estate are not deductible in figuring the estate's taxable income on Form 1041. They are deductible only for determining the taxable estate for federal estate tax purposes on Form 706.

**Medical and dental expenses of a decedent.** The medical and dental expenses of a decedent paid by the estate are not deductible in figuring the estate's taxable income on Form 1041. You can deduct them in figuring the taxable estate for federal estate tax purposes on Form 706. If these expenses are paid within the 1-year period beginning with the day after the decedent's death, you can elect to deduct them on the decedent's income tax return (Form 1040) for the year in which they were incurred. See *Medical Expenses* under *Final Return for Decedent*, earlier.

## Credits, Tax, and Payments

This section includes brief discussions of some of the tax credits, types of taxes that may be owed, and estimated tax payments that are reported on the estate's income tax return, Form 1041.

### Credits

Estates generally are allowed some of the same tax credits that are allowed to individuals. The credits generally are allocated between the estate and the beneficiaries. However, estates are not allowed the credit for the elderly or the disabled, the child tax credit, or the earned income credit discussed earlier under *Final Return for Decedent*.

**Foreign tax credit.** The foreign tax credit is discussed in Publication 514, *Foreign Tax Credit for Individuals*.

**General business credit.** The general business credit is available to an estate that is involved in a business. For more information, see Publication 334.

### Tax

An estate cannot use the Tax Table that applies to individuals. The tax rate schedule to use is in the instructions for Form 1041.

**Alternative minimum tax (AMT).** An estate may be liable for the alternative minimum tax. To figure the alternative minimum tax, use Schedule I (Form 1041), *Alternative Minimum Tax*. Certain credits may be limited by any tentative minimum tax figured on line 37, Part III of Schedule I (Form 1041), even if there is no alternative minimum tax liability.

If the estate takes a deduction for distributions to beneficiaries, complete Part I and Part II of Schedule I even if the estate does not owe alternative minimum tax. Allocate the income distribution deduction figured on a minimum tax basis among the beneficiaries and report each beneficiary's share on Schedule K-1 (Form 1041). Also, show each beneficiary's share of any adjustments or tax preference items for depreciation, depletion, and amortization.

For more information, see the instructions for Form 1041.

### Payments

The estate's income tax liability must be paid in full when the return is filed. You may have to pay estimated tax, however, as explained below.

**Estimated tax.** Estates with tax years ending 2 or more years after the date of the decedent's death must pay estimated tax in the same manner as individuals.

If you must make estimated tax payments for 2003, use **Form 1041-ES**, *Estimated Income Tax for Estates and Trusts*, to determine the estimated tax to be paid.

Generally, you must pay estimated tax if the estate is expected to owe, after subtracting any withholding and credits, at least \$1,000 in tax for 2003. You will not, however, have to pay esti-

ated tax if you expect the withholding and credits to be at least:

- 1) 90% of the tax to be shown on the 2003 return, or
- 2) 100% of the tax shown on the 2002 return (assuming the return covered all 12 months).

The percentage in (2) above is 110% if the estate's 2002 adjusted gross income (AGI) was more than \$150,000. To figure the estate's AGI, see the instructions for line 15b, Form 1041.

The general rule is that you must make your first estimated tax payment by April 15, 2003. You can either pay all of your estimated tax at that time or pay it in four equal amounts that are due by April 15, 2003; June 16, 2003; September 15, 2003; and January 15, 2004. For exceptions to the general rule, see the instructions for Form 1041-ES and Publication 505, *Tax Withholding and Estimated Tax*.

If your return is on a fiscal year basis, your due dates are the 15th day of the 4th, 6th, and 9th months of your fiscal year and the 1st month of the following fiscal year.

If any of these dates fall on a Saturday, Sunday, or legal holiday, the payment must be made by the next business day.

You may be charged a penalty for not paying enough estimated tax or for not making the payment on time in the required amount (even if you have an overpayment on your tax return). You can use Form 2210, *Underpayment of Estimated Tax by Individuals, Estates, and Trusts*, to figure any penalty, or you can let the IRS figure the penalty.

For more information, see the instructions for Form 1041-ES and Publication 505.

## Name, Address, and Signature

In the top space of the name and address area of Form 1041, enter the exact name of the estate from the Form SS-4 used to apply for the estate's employer identification number. In the remaining spaces, enter the name and address of the personal representative (fiduciary) of the estate.

**Signature.** The personal representative (or its authorized officer if the personal representative is not an individual) must sign the return. An individual who prepares the return for pay must manually sign the return as preparer. You can check a box in the signature area that authorizes the IRS to contact that paid preparer for certain information. See the instructions for Form 1041 for more information.

## When and Where To File

When you file Form 1041 (or Form 1040NR if it applies) depends on whether you choose a calendar year or a fiscal year as the estate's accounting period. Where you file Form 1041 depends on where you, as the personal representative, live or have your principal office.

**When to file.** If you choose the calendar year as the estate's accounting period, the Form 1041 for 2002 is due by April 15, 2003 (June 16, 2003, in the case of Form 1040NR for a nonresident alien estate that does not have an office in

the United States). If you choose a fiscal year, the Form 1041 is due by the 15th day of the 4th month (6th month in the case of Form 1040NR) after the end of the tax year. If the due date is a Saturday, Sunday, or legal holiday, the form must be filed by the next business day.

**Extension of time to file.** An extension of time to file Form 1041 may be granted if you have clearly described the reasons that will cause your delay in filing the return. Use Form 2758, *Application for Extension of Time To File Certain Excise, Income, Information, and Other Returns*, to request an extension. The extension is not automatic, so you should request it early enough for the IRS to act on the application before the regular due date of Form 1041. You should file Form 2758 in duplicate with the IRS office where you must file Form 1041.

If you have not yet established an accounting period, filing Form 2758 will serve to establish the accounting period stated on that form. Changing to another accounting period requires prior approval by the IRS.

Generally, an extension of time to file a return **does not extend the time for payment of tax due**. You must pay the total income tax estimated to be due on Form 1041 in full by the regular due date of the return. For additional information, see the instructions for Form 2758.

**Where to file.** As the personal representative of an estate, file the estate's income tax return (Form 1041) with the Internal Revenue Service center for the state where you live or have your principal place of business. A list of the states and addresses that apply is in the instructions for Form 1041.

You must send Form 1040NR to the Internal Revenue Service Center, Philadelphia, PA 19255.

**Electronic filing.** Form 1041 can be filed electronically or on magnetic media. See the instructions for Form 1041 for more information.

## Distributions to Beneficiaries From an Estate

If you are the beneficiary of an estate that must distribute all its income currently, you must report your share of the distributable net income whether or not you have actually received it.

If you are the beneficiary of an estate that does not have to distribute all its income currently, you must report all income that must be distributed to you (whether or not actually distributed) plus all other amounts paid, credited, or required to be distributed to you, up to your share of distributable net income. As explained earlier in *Distributions Deduction under Income Tax Return of an Estate—Form 1041*, for an amount to be currently distributable income, there must be a specific requirement for current distribution either under local law or the terms of the decedent's will. If there is no such requirement, the income is reportable only when distributed.

If the estate has more than one beneficiary, the separate shares rule discussed earlier under *Distributions Deduction* may have to be used to

determine the distributable net income allocable to each beneficiary. The beneficiaries in the examples shown next do not meet the requirements of the separate shares rule.

### Income That Must Be Distributed Currently

Beneficiaries who are entitled to receive currently distributable income generally must include in gross income the entire amount due them. However, if the currently distributable income is more than the estate's distributable net income figured without deducting charitable contributions, each beneficiary must include in gross income a ratable part of the distributable net income.

**Example.** Under the terms of the will of Gerald Peters, \$5,000 a year is to be paid to his widow and \$2,500 a year is to be paid to his daughter out of the estate's income during the period of administration. There are no charitable contributions. For the year, the estate's distributable net income is only \$6,000. The distributable net income is less than the currently distributable income, so the widow must include in her gross income only \$4,000  $[(\$5,000 \div \$7,500) \times \$6,000]$ , and the daughter must include in her gross income only \$2,000  $[(\$2,500 \div \$7,500) \times \$6,000]$ .

**Annuity payable out of income or corpus.** Income that must be distributed currently includes any amount that must be paid out of income or corpus (principal of the estate) to the extent the amount is satisfied out of income for the tax year. An annuity that must be paid in all events (either out of income or corpus) would qualify as income that must be distributed currently to the extent there is income of the estate not paid, credited, or required to be distributed to other beneficiaries for the tax year.

**Example 1.** Henry Frank's will provides that \$500 be paid to the local Community Chest out of income each year. It also provides that \$2,000 a year is currently distributable out of income to his brother, Fred, and an annuity of \$3,000 is to be paid to his sister, Sharon, out of income or corpus. Capital gains are allocable to corpus, but all expenses are to be charged against income. Last year, the estate had income of \$6,000 and expenses of \$3,000. The personal representative paid the \$500 to the Community Chest and made the distributions to Fred and Sharon as required by the will.

The estate's distributable net income (figured before the charitable contribution) is \$3,000. The currently distributable income totals \$2,500 (\$2,000 to Fred and \$500 to Sharon). The income available for Sharon's annuity is only \$500 because the will requires that the charitable contribution be paid out of current income. The \$2,500 treated as distributed currently is less than the \$3,000 distributable net income (before the contribution), so Fred must include \$2,000 in his gross income and Sharon must include \$500 in her gross income.

**Example 2.** Assume the same facts as in *Example 1* except that the estate has an additional \$1,000 of administration expenses, commissions, etc., that are chargeable to corpus. The estate's distributable net income (figured

before the charitable contribution) is now \$2,000 (\$3,000 – \$1,000 additional expense). The amount treated as currently distributable income is still \$2,500 (\$2,000 to Fred and \$500 to Sharon). The \$2,500, treated as distributed currently, is more than the \$2,000 distributable net income, so Fred has to include only \$1,600  $[(\$2,000 \div \$2,500) \times \$2,000]$  in his gross income and Sharon has to include only \$400  $[(\$500 \div \$2,500) \times \$2,000]$  in her gross income. Fred and Sharon are beneficiaries of amounts that must be distributed currently, so they do not benefit from the reduction of distributable net income by the charitable contribution deduction.

### Other Amounts Distributed

Any other amount paid, credited, or required to be distributed to the beneficiary for the tax year also must be included in the beneficiary's gross income. Such an amount is in addition to those amounts that must be distributed currently, as discussed earlier. It does not include gifts or bequests of specific sums of money or specific property if such sums are paid in three or fewer installments. However, amounts that can be paid only out of income are not excluded under this rule. If the sum of the income that must be distributed currently and other amounts paid, credited, or required to be distributed exceeds distributable net income, these other amounts are included in the beneficiary's gross income only to the extent distributable net income exceeds the income that must be distributed currently. If there is more than one beneficiary, each will include in gross income only a pro rata share of such amounts.

The personal representative can elect to treat distributions paid or credited by the estate within 65 days after the close of the estate's tax year as having been paid or credited on the last day of that tax year.

**The following are examples of other amounts distributed.**

- Distributions made at the discretion of the personal representative.
- Distributions required by the terms of the will upon the happening of a specific event.
- Annuities that must be paid in any event, but only out of corpus (principal).
- Distributions of property in kind as defined earlier in *Distributions Deduction under Income Tax Return of an Estate—Form 1041*.
- Distributions required for the support of the decedent's surviving spouse or other dependent for a limited period, but only out of corpus (principal).

If an estate distributes property in kind, the amount of the distribution ordinarily is the lesser of the estate's basis in the property or the property's fair market value when distributed. However, the amount of the distribution is the property's fair market value if the estate recognizes gain on the distribution. See *Gain or loss on distributions in kind* in the discussion *Income To Include under Income Tax Return of an Estate—Form 1041*, earlier.



**Example.** The terms of Michael Scott's will require the distribution of \$2,500 of income annually to his wife, Susan. If any income remains, it may be accumulated or distributed to his two children, Joe and Alice, in amounts at the discretion of the personal representative. The personal representative also may invade the corpus (principal) for the benefit of Scott's wife and children.

Last year, the estate had income of \$6,000 after deduction of all expenses. Its distributable net income is also \$6,000. The personal representative distributed the required \$2,500 of income to Susan. In addition, the personal representative distributed \$1,500 each to Joe and Alice and an additional \$2,000 to Susan.

Susan includes in her gross income the \$2,500 of currently distributable income. The other amounts distributed totaled \$5,000 (\$1,500 + \$1,500 + \$2,000) and are includible in the income of Susan, Joe, and Alice to the extent of \$3,500 (distributable net income of \$6,000 minus currently distributable income to Susan of \$2,500). Susan will include an additional \$1,400  $[(\$2,000 \div \$5,000) \times \$3,500]$  in her gross income. Joe and Alice each will include \$1,050  $[(\$1,500 \div \$5,000) \times \$3,500]$  in their gross incomes.

## Discharge of a Legal Obligation

If an estate, under the terms of a will, discharges a legal obligation of a beneficiary, the discharge is included in that beneficiary's income as either currently distributable income or other amount paid. This does not apply to the discharge of a beneficiary's obligation to pay alimony or separate maintenance.

The beneficiary's legal obligations include a legal obligation of support, for example, of a minor child. Local law determines a legal obligation of support.

## Character of Distributions

An amount distributed to a beneficiary for inclusion in gross income retains the same character for the beneficiary that it had for the estate.

**No charitable contribution made.** If no charitable contribution is made during the tax year, you must treat the distributions as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income. Distributable net income was defined earlier in *Distributions Deduction under Income Tax Return of an Estate—Form 1041*. However, if the will or local law specifically provides or requires a different allocation, you must use that allocation.

**Example 1.** An estate has distributable net income of \$3,000, consisting of \$1,800 in rents and \$1,200 in taxable interest. There is no provision in the will or local law for the allocation of income. The personal representative distributes \$1,500 each to Jim and Ted, beneficiaries under their father's will. Each will be treated as having received \$900 in rents and \$600 of taxable interest.

**Example 2.** Assume in Example 1 that the will provides for the payment of the taxable inter-

est to Jim and the rental income to Ted and that the personal representative distributed the income under those provisions. Jim is treated as having received \$1,200 in taxable interest and Ted is treated as having received \$1,800 of rental income.

**Charitable contribution made.** If a charitable contribution is made by an estate and the terms of the will or local law provide for the contribution to be paid from specified sources, that provision governs. If no provision or requirement exists, the charitable contribution deduction must be allocated among the classes of income entering into the computation of the income of the estate before allocation of other deductions among the items of distributable net income. In allocating items of income and deductions to beneficiaries to whom income must be distributed currently, the charitable contribution deduction is not taken into account to the extent that it exceeds income for the year reduced by currently distributable income.

**Example.** The will of Harry Thomas requires a current distribution out of income of \$3,000 a year to his wife, Betty, during the administration of the estate. The will also provides that the personal representative, using discretion, may distribute the balance of the current earnings either to Harry's son, Tim, or to one or more of certain designated charities. Last year, the estate's income consisted of \$4,000 of taxable interest and \$1,000 of tax-exempt interest. There were no deductible expenses. The personal representative distributed the \$3,000 to Betty, made a contribution of \$2,500 to the local heart association, and paid \$1,500 to Tim.

The distributable net income for determining the character of the distribution to Betty is \$3,000. The charitable contribution deduction to be taken into account for this computation is \$2,000 (the estate's income (\$5,000) minus the currently distributable income (\$3,000)). The \$2,000 charitable contribution deduction must be allocated: \$1,600  $[(\$4,000 \div \$5,000) \times \$2,000]$  to taxable interest and \$400  $[(\$1,000 \div \$5,000) \times \$2,000]$  to tax-exempt interest. Betty is considered to have received \$2,400 (\$4,000 – \$1,600) of taxable interest and \$600 (\$1,000 – \$400) of tax-exempt interest. She must include the \$2,400 in her gross income. She must report the \$600 of tax-exempt interest, but it is not taxable.

To determine the amount to be included in Tim's gross income, however, take into account the entire charitable contribution deduction. The currently distributable income is greater than the estate's income after taking into account the charitable contribution deduction, so none of the amount paid to Tim must be included in his gross income for the year.

## How and When To Report

How you report your income from the estate depends on the character of the income in the hands of the estate. When you report the income depends on whether it represents amounts credited or required to be distributed to you or other amounts.

**How to report estate income.** Each item of income keeps the same character in your hands as it had in the hands of the estate. If the items of income distributed or considered to be distrib-

uted to you include dividends, tax-exempt interest, or capital gains, they will keep the same character in your hands for purposes of the tax treatment given those items. Generally, you report the dividends on line 9 of your Form 1040, and the capital gains on your Schedule D (Form 1040). The tax-exempt interest, while not included in taxable income, must be shown on line 8b of your Form 1040. Report business and other nonpassive income in Part III of your Schedule E (Form 1040).

The estate's personal representative should provide you with the classification of the various items that make up your share of the estate income and the credits you should take into consideration so that you can properly prepare your individual income tax return. See *Schedule K-1 (Form 1041)*, later.

**When to report estate income.** If income from the estate is credited or must be distributed to you for a tax year, report that income (even if not distributed) on your return for that year. The personal representative can elect to treat distributions paid or credited within 65 days after the close of the estate's tax year as having been paid or credited on the last day of that tax year. If this election is made, you must report that distribution on your return for that year.

Report other income from the estate on your return for the year in which you receive it. If your tax year is different from the estate's tax year, see *Different tax years*, next.

**Different tax years.** You must include your share of the estate income in your return for your tax year in which the last day of the estate's tax year falls. If the tax year of the estate is the calendar year and your tax year is a fiscal year ending on June 30, you will include in gross income for the tax year ended June 30 your share of the estate's distributable net income distributed or considered distributed during the calendar year ending the previous December 31.

**Death of individual beneficiary.** If an individual beneficiary dies, the beneficiary's share of the estate's distributable net income may be distributed or be considered distributed by the estate for its tax year that does not end with or within the last tax year of the beneficiary. In this case, the estate income that must be included in the gross income on the beneficiary's final return is based on the amounts distributed or considered distributed during the tax year of the estate in which his or her last tax year ended. However, for a cash basis beneficiary, the gross income of the last tax year includes only the amounts actually distributed before death. Income that must be distributed to the beneficiary but, in fact, is distributed to the beneficiary's estate after death is included in the gross income of the beneficiary's estate as income in respect of a decedent.

**Termination of nonindividual beneficiary.** If a beneficiary that is not an individual, for example a trust or a corporation, ceases to exist, the amount included in its gross income for its last tax year is determined as if the beneficiary were a deceased individual. However, income that must be distributed before termination, but which is actually distributed to the beneficiary's successor in interest, is included in the gross income of the nonindividual beneficiary for its last tax year.

**Schedule K-1 (Form 1041).** The personal representative for the estate must provide you with a copy of Schedule K-1 (Form 1041) or a substitute Schedule K-1. You should not file the form with your Form 1040, but should keep it for your personal records.

Each beneficiary (or nominee of a beneficiary) who receives a distribution from the estate for the tax year or to whom any item is allocated must receive a Schedule K-1 or substitute. The personal representative handling the estate must furnish the form to each beneficiary or nominee by the date on which the Form 1041 is filed.

**Nominees.** A person who holds an interest in an estate as a nominee for a beneficiary must provide the estate with the name and address of the beneficiary, and any other required information. The nominee must provide the beneficiary with the information received from the estate.

**Penalty.** A personal representative (or nominee) who fails to provide the correct information may be subject to a \$50 penalty for each failure.

**Consistent treatment of items.** You must treat estate items the same way on your individual return as they are treated on the estate's income tax return. If your treatment is different from the estate's treatment, you must file Form 8082, *Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR)*, with your return to identify the difference. If you do not file Form 8082 and the estate has filed a return, the IRS can immediately assess and collect any tax and penalties that result from adjusting the item to make it consistent with the estate's treatment.

## Bequest

A bequest is the act of giving or leaving property to another through the last will and testament. Generally, any distribution of income (or property in kind) to a beneficiary is an allowable deduction to the estate and is includible in the beneficiary's gross income to the extent of the estate's distributable net income. However, a distribution will not be an allowable deduction to the estate and will not be includible in the beneficiary's gross income if the distribution meets the following requirements.

- It is required by the terms of the will.
- It is a gift or bequest of a **specific sum of money or property**.
- It is paid out in three or fewer installments under the terms of the will.

**Specific sum of money or property.** To meet this test, the amount of money or the identity of the specific property must be determinable under the decedent's will as of the date of death. To qualify as specific property, the property must be identifiable both as to its kind and its amount.

**Example 1.** Dave Rogers' will provided that his son, Ed, receive Dave's interest in the Rogers-Jones partnership. Dave's daughter, Marie, would receive a sum of money equal to the value of the partnership interest given to Ed. The bequest to Ed is a gift of a specific property ascertainable at the date of Dave Rogers' death.

The bequest of a specific sum of money to Marie is determinable on the same date.

**Example 2.** Mike Jenkins' will provided that his widow, Helen, would receive money or property to be selected by the personal representative equal in value to half of his adjusted gross estate. The identity of the property and the money in the bequest are dependent on the personal representative's discretion and the payment of administration expenses and other charges, which are not determinable at the date of Mike's death. As a result, the provision is not a bequest of a specific sum of money or of specific property, and any distribution under that provision is a deduction for the estate and income to the beneficiary (to the extent of the estate's distributable net income). The fact that the bequest will be specific sometime before distribution is immaterial. It is not ascertainable by the terms of the will as of the date of death.

**Distributions not treated as bequests.** The following distributions are not bequests that meet all the requirements listed earlier that allow a distribution to be excluded from the beneficiary's income and do not allow it as a deduction to the estate.

**Paid only from income.** An amount that can be paid only from current or prior income of the estate does not qualify even if it is specific in amount and there is no provision for installment payments.

**Annuity.** An annuity or a payment of money or of specific property in lieu of, or having the effect of, an annuity is not the payment of a specific property or sum of money.

**Residuary estate.** If the will provides for the payment of the balance or residue of the estate to a beneficiary of the estate after all expenses and other specific legacies or bequests, that residuary bequest is not a payment of a specific property or sum of money.

**Gifts made in installments.** Even if the gift or bequest is made in a lump sum or in three or fewer installments, it will not qualify as a specific property or sum of money if the will provides that the amount must be paid in more than three installments.

**Conditional bequests.** A bequest of a specific property or sum of money that may otherwise be excluded from the beneficiary's gross income will not lose the exclusion solely because the payment is subject to a condition.

**Installment payments.** Certain rules apply in determining whether a bequest of specific property or a sum of money has to be paid or credited to a beneficiary in more than three installments.

**Personal items.** Do not take into account bequests of articles for personal use, such as personal and household effects and automobiles.

**Real property.** Do not take into account specifically designated real property, the title to which passes under local law directly to the beneficiary.

**Other property.** All other bequests under the decedent's will for which no time of payment or crediting is specified and that are to be paid or credited in the ordinary course of administration of the estate are considered as required to be

paid or credited in a single installment. Also, all bequests payable at any one specified time under the terms of the will are treated as a single installment.

**Testamentary trust.** In determining the number of installments that must be paid or credited to a beneficiary, the decedent's estate and a testamentary trust created by the decedent's will are treated as separate entities. Amounts paid or credited by the estate and by the trust are counted separately.

## Termination of Estate

The termination of an estate generally is marked by the end of the period of administration and by the distribution of the assets to the beneficiaries under the terms of the will or under the laws of succession of the state if there is no will. These beneficiaries may or may not be the same persons as the beneficiaries of the estate's income.

## Period of Administration

The period of administration is the time actually required by the personal representative to assemble all of the decedent's assets, pay all the expenses and obligations, and distribute the assets to the beneficiaries. This may be longer or shorter than the time provided by local law for the administration of estates.

**Ends if all assets distributed.** If all assets are distributed except for a reasonable amount set aside, in good faith, for the payment of unascertained or contingent liabilities and expenses (but not including a claim by a beneficiary, as a beneficiary) the estate will be considered terminated.

**Ends if period unreasonably long.** If settlement is prolonged unreasonably, the estate will be treated as terminated for federal income tax purposes. From that point on, the income, deductions, and credits of the estate are considered those of the person or persons succeeding to the property of the estate.

## Transfer of Unused Deductions to Beneficiaries

If the estate has unused loss carryovers or excess deductions for its last tax year, they are allowed to those beneficiaries who succeed to the estate's property. See *Successor beneficiary*, later.

**Unused loss carryovers.** An unused net operating loss carryover or capital loss carryover existing upon termination of the estate is allowed to the beneficiaries succeeding to the property of the estate. That is, these deductions will be claimed on the beneficiary's tax return. This treatment occurs only if a carryover would have been allowed to the estate in a later tax year if the estate had not been terminated.

Both types of carryovers generally keep their same character for the beneficiary as they had for the estate. However, if the beneficiary of a capital loss carryover is a corporation, the corporation will treat the carryover as a short-term capital loss regardless of its status in the estate. The net operating loss carryover and the capital loss carryover are used in figuring the

beneficiary's adjusted gross income and taxable income. The beneficiary may have to adjust any net operating loss carryover in figuring the alternative minimum tax.

The first tax year to which the loss is carried is the beneficiary's tax year in which the estate terminates. If the loss can be carried to more than one tax year, the estate's last tax year (whether or not a short tax year) and the beneficiary's first tax year to which the loss is carried each constitute a tax year for figuring the number of years to which a loss may be carried. A capital loss carryover from an estate to a corporate beneficiary will be treated as though it resulted from a loss incurred in the estate's last tax year (whether or not a short tax year), regardless of when the estate actually incurred the loss.

If the last tax year of the estate is the last tax year to which a net operating loss may be carried, see *No double deductions*, later. For a general discussion of net operating losses, see Publication 536. For a discussion of capital losses and capital loss carryovers, see Publication 550.

**Excess deductions.** If the deductions in the estate's last tax year (other than the exemption deduction or the charitable contributions deduction) are more than gross income for that year, the beneficiaries succeeding to the estate's property can claim the excess as a deduction in figuring taxable income. To establish these deductions for the beneficiaries, a return must be filed for the estate along with a schedule showing the computation of each kind of deduction and the allocation of each to the beneficiaries.

An individual beneficiary must itemize deductions to claim these excess deductions. The deduction is claimed on Schedule A (Form 1040), subject to the 2% limit on miscellaneous itemized deductions. The beneficiaries can claim the deduction only for the tax year in which or with which the estate terminates, whether the year of termination is a normal year or a short tax year.

**No double deductions.** A net operating loss deduction allowable to a successor beneficiary cannot be considered in figuring the excess deductions on termination. However, if the estate's last tax year is the last year in which a deduction for a net operating loss can be taken, the deduction, to the extent not absorbed in the last return of the estate, is treated as an excess deduction on termination. Any item of income or deduction, or any part thereof, that is taken into account in figuring a net operating loss or a capital loss carryover of the estate for its last tax year cannot be used again to figure the excess deduction on termination.

**Successor beneficiary.** A beneficiary entitled to an unused loss carryover or an excess deduction is the beneficiary who, upon the estate's termination, bears the burden of any loss for which a carryover is allowed or of any deductions more than gross income.

**If decedent had no will.** If the decedent had no will, the beneficiaries are those heirs or next of kin to whom the estate is distributed. If the estate is insolvent, the beneficiaries are those to whom the estate would have been distributed had it not been insolvent. If the decedent's spouse is entitled to a specified dollar amount of property before any distributions to

other heirs and the estate is less than that amount, the spouse is the beneficiary to the extent of the deficiency.

**If decedent had a will.** If the decedent had a will, a beneficiary normally means the residuary beneficiaries (including residuary trusts). Those beneficiaries who receive a specific property or a specific amount of money ordinarily are not considered residuary beneficiaries, except to the extent the specific amount is not paid in full.

Also, a beneficiary who is not strictly a residuary beneficiary, but whose devise or bequest is determined by the value of the estate as reduced by the loss or deduction, is entitled to the carryover or the deduction. For example, this would include the following beneficiaries.

- A beneficiary of a fraction of the decedent's net estate after payment of debts, expenses, and specific bequests.
- A nonresiduary beneficiary, when the estate is unable to satisfy the bequest in full.
- A surviving spouse receiving a fractional share of the estate in fee under a statutory right of election when the losses or deductions are taken into account in determining the share. However, such a beneficiary does not include a recipient of a dower or curtesy, or a beneficiary who receives any income from the estate from which the loss or excess deduction is carried over.

**Allocation among beneficiaries.** The total of the unused loss carryovers or the excess deductions on termination that may be deducted by the successor beneficiaries is to be divided according to the share of each in the burden of the loss or deduction.

**Example.** Under his father's will, Arthur is to receive \$20,000. The remainder of the estate is to be divided equally between his brothers, Mark and Tom. After all expenses are paid, the estate has sufficient funds to pay Arthur only \$15,000, with nothing to Mark and Tom. In the estate's last tax year there are excess deductions of \$5,000 and \$10,000 of unused loss carryovers. The total of the excess deductions and unused loss carryovers is \$15,000 and Arthur is considered a successor beneficiary to the extent of \$5,000, so he is entitled to one-third of the unused loss carryover and one-third of the excess deductions. His brothers may divide the other two-thirds of the excess deductions and the unused loss carryovers between them.

## Transfer of Credit for Estimated Tax Payments

When an estate terminates, the personal representative can choose to transfer to the beneficiaries the credit for all or part of the estate's estimated tax payments for the last tax year. To make this choice, the personal representative must complete Form 1041-T, *Allocation of Estimated Tax Payments to Beneficiaries*, and file it either separately or with the estate's final Form 1041. The Form 1041-T must be filed by the 65th day after the close of the estate's tax year.

The amount of estimated tax allocated to each beneficiary is treated as paid or credited to

the beneficiary on the last day of the estate's final tax year and must be reported on line 14a, Schedule K-1 (Form 1041). If the estate terminated in 2002 this amount is treated as a payment of 2002 estimated tax made by the beneficiary on January 15, 2003.

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## Form 706

Generally, for estate tax purposes, you must file Form 706, *United States Estate (and Generation-Skipping Transfer) Tax Return*. If death occurred in 2002, Form 706 must be filed if the gross estate is more than \$1,000,000.

If you must file Form 706, it has to be done within 9 months after the date of the decedent's death unless you receive an extension of time to file. Use Form 4768, *Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes*, to apply for an extension of time.

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## Comprehensive Example

The following is an example of a typical situation. All figures on the filled-in forms have been rounded to the nearest whole dollar.

On April 9, 2002, your father, John R. Smith, died at the age of 62. He had not resided in a community property state. His will named you to serve as his executor (personal representative). Except for specific bequests to your mother, Mary, of your parents' home and your father's automobile and a bequest of \$5,000 to his church, your father's will named your mother and his brother as beneficiaries.

After the court has approved your appointment as the executor, you should obtain an employer identification number for the estate. (See *Duties under Personal Representatives*, earlier.) Next, you use Form 56 to notify the Internal Revenue Service that you have been appointed executor of your father's estate.

**Assets of the estate.** Your father had the following assets when he died.

- His checking account balance was \$2,550 and his savings account balance was \$53,650.
- Your father inherited your parents' home from his parents on March 5, 1979. At that time it was worth \$42,000, but was appraised at the time of your father's death at \$150,000. The home was free of existing debts (or mortgages) at the time of his death.
- Your father owned 500 shares of ABC Company stock that had cost him \$10.20 a share in 1983. The stock had a mean selling price (midpoint between highest and lowest selling price) of \$25 a share on the day he died. He also owned 500 shares of XYZ Company stock that had cost him \$20 a share in 1988. The stock had a mean selling price on the date of death of \$62.



- The appraiser valued your father's automobile at \$6,300 and the household effects at \$18,500.
- Your father owned a coin collection and a stamp collection. The face value of the coins in the collection was only \$600, but the appraiser valued it at \$2,800. The stamp collection was valued at \$3,500.
- Your father's employer sent a check to your mother for \$11,082 (\$12,000 – \$918 for social security and Medicare taxes), representing unpaid salary and payment for accrued vacation time. The statement that came with the check indicated that no amount was withheld for income tax. The check was made out to the estate, so your mother gave you the check.
- The Easy Life Insurance Company gave your mother a check for \$275,000 because she was the beneficiary of his life insurance policy.
- Your father was the owner of several series EE U.S. savings bonds on which he named your mother as co-owner. Your father purchased the bonds during the past several years. The cost of these bonds totaled \$2,500. After referring to the appropriate table of redemption values (see *U.S. savings bonds acquired from decedent*, earlier), you determine that interest of \$840 had accrued on the bonds at the date of your father's death. You must include the redemption value of these bonds at date of death, \$3,340, in your father's gross estate.
- On July 1, 1992, your parents purchased a house for \$90,000. They have held the property for rental purposes continuously since its purchase. Your mother paid one-third of the purchase price, or \$30,000, and your father paid \$60,000. They owned the property, however, as joint tenants with right of survivorship. An appraiser valued the property at \$120,000. You include \$60,000, one-half of the value, in your father's gross estate because your parents owned the property as joint tenants with right of survivorship and they were the only joint tenants.

Your mother also gave you a Form W-2, *Wage and Tax Statement*, that your father's employer had sent. In examining it, you discover that your father had been paid \$11,000 in salary between January 1, 2002, and April 9, 2002, (the date he died). The Form W-2 showed \$11,000 in box 1 and \$23,000 (\$11,000 + \$12,000) in boxes 3 and 5. The Form W-2 indicated \$1,305 as federal income tax withheld in box 2. The estate received a Form 1099-MISC from the employer showing \$12,000 in box 3. The estate received a Form 1099-INT for your father showing he was paid \$1,900 interest on his savings account at the First S&L of Juneville, in 2002, before he died.

## Final Return for Decedent

From the papers in your father's files, you determine that the \$11,000 paid to him by his employer (as shown on the Form W-2), rental

income, and interest are the only items of income he received between January 1 and the date of his death. You will have to file an income tax return for him for the period during which he lived. (You determine that he timely filed his 2001 income tax return before he died.) The final return is not due until April 15, 2003, the same date it would have been due had your father lived during all of 2002.

The check representing unpaid salary and earned but unused vacation time was not paid to your father before he died, so the \$12,000 is not reported as income on his final return. It is reported on the income tax return for the estate (Form 1041) for 2002. The only taxable income to be reported for your father will be the \$11,000 salary (as shown on the Form W-2), the \$1,900 interest, and his portion of the rental income that he received in 2002.

Your father was a cash basis taxpayer and did not report the interest accrued on the series EE U.S. savings bonds on prior tax returns that he filed jointly with your mother. As the personal representative of your father's estate, you choose to report the interest earned on these bonds before your father's death (\$840) on the final income tax return.

The rental property was leased the entire year of 2002 for \$1,000 per month. Under local law, your parents (as joint tenants) each had a half interest in the income from the property. Your father's will, however, stipulates that the entire rental income is to be paid directly to your mother. None of the rental income will be reported on the income tax return for the estate. Instead, your mother will report all the rental income and expenses on Form 1040. Checking the records and prior tax returns of your parents, you find that they previously elected to use the alternative depreciation system (ADS) with the mid-month convention. Under ADS, the rental house is depreciated using the straight-line method over a 40-year recovery period. They allocated \$15,000 of the cost to the land (which is never depreciable) and \$75,000 to the rental house. Salvage value was disregarded for the depreciation computation. Before 2002, \$17,735 had been allowed as depreciation. (For information on ADS, see Publication 946.)

**Deductions.** During the year, you received a bill from the hospital for \$615 and bills from your father's doctors totaling \$475. You paid these bills as they were presented. In addition, you find other bills from his doctors totaling \$185 that your father paid in 2002 and receipts for prescribed drugs he purchased totaling \$36. The funeral home presented you a bill for \$6,890 for the expenses of your father's funeral, which you paid.

The medical expenses you paid from the estate's funds (\$615 and \$475) were for your father's care and were paid within 1 year after his death, and they will not be used to figure the taxable estate, so you can treat them as having been paid by your father when he received the medical services. See *Medical Expenses* under *Final Return for Decedent*, earlier. However, you cannot deduct the funeral expenses either on your father's final return or on the estate's income tax return. They are deductible only on the federal estate tax return (Form 706).

In addition, after going over other receipts and canceled checks for the tax year with your mother, you determine that the following items

are deductible on your parents' 2002 income tax return.

Health insurance . . . . .	\$3,250
State income tax paid . . . . .	891
Real estate tax on home . . . . .	1,100
Contributions to church . . . . .	3,800

Rental expenses included real estate taxes of \$700 and mortgage interest of \$410. In addition, insurance premiums of \$260 and painting and repair expenses for \$350 were paid. These rental expenses totaled \$1,720.

Your mother and father owned the property as joint tenants with right of survivorship and they were the only joint tenants, so her basis in this property upon your father's death is \$95,859. This is found by adding the \$60,000 value of the half interest included in your father's gross estate to your mother's \$45,000 share of the cost basis and subtracting your mother's \$9,141 share of depreciation (including 2002 depreciation for the period before your father's death), as explained next.

For 2002, you must make the following computations to figure the depreciation deduction.

- 1) For the period before your father's death, depreciate the property using the same method, basis, and life used by your parents in previous years. They used the mid-month convention, so the amount deductible for three and a half months is \$547. (This brings the total depreciation to \$18,282 (\$17,735 + \$547) at the time of your father's death.
- 2) For the period after your father's death, you must make two computations.
  - a) Your mother's cost basis (\$45,000) minus one-half of the amount allocated to the land (\$7,500) is her depreciable basis (\$37,500) for half of the property. She continues to use the same life and depreciation method as was originally used for the property. The amount deductible for the remaining eight and a half months is \$664.
  - b) The other half of the property must be depreciated using a depreciation method that is acceptable for property placed in service in 2002. You chose to use ADS with the mid-month convention. The value included in the estate (\$60,000) less the value allocable to the land (\$10,000) is the depreciable basis (\$50,000) for this half of the property. The amount deductible for this half of the property is \$886 (\$50,000 × .01771). See chapter 3 and *Table A-13* in Publication 946.

Show the total of the amounts in (1) and (2)(a), above, on line 17 of Form 4562, *Depreciation and Amortization*. Show the amount in (2)(b) on line 20c. The total depreciation deduction allowed for the year is \$2,097.

**Filing status.** After December 31, 2002, when your mother determines the amount of her income, you and your mother must decide whether you will file a joint return or separate returns for your parents for 2002. Your mother has rental income and \$400 of interest income from her savings account at the Mayflower Bank

of Juneville, so it appears to be to her advantage to file a joint return.

**Tax computation.** The illustrations of Form 1040 and related schedules appear near the end of this publication. These illustrations are based on information in this example. The tax refund is \$542. The computation is as follows:

Income:		
Salary (per Form W-2) . . .	\$11,000	
Interest income . . . . .	3,140	
Net rental income . . . . .	<u>8,183</u>	
Adjusted gross income . . . .		\$22,323
Minus: Itemized deductions . .	8,678	
Balance . . . . .		\$13,645
Minus: Exemptions (2) . . . .	6,000	
Taxable Income . . . . .		<u>\$7,645</u>
Income tax from tax table . . .	\$763	
Minus: Tax withheld . . . . .	<u>1,305</u>	
<b>Refund of taxes</b> . . . . .		<u><b>\$542</b></u>

## Income Tax Return of an Estate—Form 1041

The illustrations of Form 1041 and the related schedules for 2002 appear near the end of this publication. These illustrations are based on the information that follows.

**2002 income tax return.** Having determined the tax liability for your father's final return, you now figure the estate's taxable income. You decide to use the calendar year and the cash method of accounting to report the estate's income. This return also is due by April 15, 2003.

In addition to the amount you received from your father's employer for unpaid salary and for vacation pay (\$12,000) entered on line 8 (Form 1041), you received a dividend check from the XYZ Company on June 17, 2002. The check was for \$750 and you enter it on line 2 (Form 1041). The estate received a Form 1099-INT showing \$2,250 interest paid by the bank on the savings account in 2002 after your father died. Show this amount on line 1 (Form 1041).

In September, a local coin collector offered you \$3,000 for your father's coin collection. Your mother was not interested in keeping the collection, so you accepted the offer and sold him the collection on September 23, 2002.

The estate has a gain from the sale of the collection. You will have to report the sale on Schedule D (Form 1041) when you file the income tax return of the estate. The estate has a capital gain of \$200 from the sale of the coins. The gain is the excess of the sale price, \$3,000, over the value of the collection at the date of your father's death, \$2,800. See *Gain (or loss) from sale of property under Income Tax Return of an Estate—Form 1041* and its discussion, *Income To Include*, earlier.

**Deductions.** In November 2002, you received a bill for the real estate taxes on the home. The bill was for \$2,250, which you paid. Include real estate taxes on line 11 (Form 1041). Real estate tax on the rental property was \$700; this amount, however, is reflected on Schedule E (Form 1040).

You paid \$325 for attorney's fees in connection with administration of the estate. This is an expense of administration and is deducted on line 14 (Form 1041). You must, however, file with the return a statement in duplicate that such

expense has not been claimed as a deduction from the gross estate for figuring the federal estate tax on Form 706, and that all rights to claim that deduction on Form 706 are waived.

**Distributions.** You made a distribution of \$2,000 to your father's brother, James. The distribution was made under the terms of the will from current income of the estate.

The income distribution deduction (\$2,000) is figured on Schedule B of Form 1041 and deducted on line 18 (Form 1041).

The distribution of \$2,000 must be allocated and reported on Schedule K-1 (Form 1041) as follows:

Step 1			
Allocation of Income & Deductions			
Type of Income	Amount	Deductions	Distributable Net Income
Interest (15%)	\$ 2,250	(386)	\$ 1,864
Dividends (5%)	750	(129)	621
Other Income (80%)	12,000	(2,060)	9,940
<b>Total</b>	<b>\$15,000</b>	<b>(2,575)</b>	<b>\$12,425</b>

Step 2	
Allocation of Distribution	
(Report on the Schedule K-1 for James)	
Line 1 – Interest (\$2,000 × 1,864/12,425) . . . . .	\$300
Line 2 – Dividends (\$2,000 × 621/12,425) . . . . .	100
Line 5a – Other Income (\$2,000 × 9,940/12,425) . . . . .	1,600
<b>Total Distribution</b> . . . . .	<b>\$2,000</b>

The estate took an income distribution deduction, so you must prepare Schedule I (Form 1041), *Alternative Minimum Tax*, regardless of whether the estate is liable for the alternative minimum tax.

The other distribution you made out of the assets of the estate in 2002 was the transfer of the automobile to your mother on July 1. This is included in the bequest of property, so it is not taken into account in computing the distributions of income to the beneficiary. The life insurance proceeds of \$275,000 paid directly to your mother by the insurance company are treated as a specific sum of money transferred to your mother under the terms of the will.

**Tax computation.** The taxable income of the estate for 2002 is \$10,025, figured as follows:

<b>Gross income:</b>	
Income in respect of a decedent . . . .	\$12,000
Dividends . . . . .	750
Interest . . . . .	2,250
Capital gain . . . . .	<u>200</u>
	\$15,200
<b>Minus: Deductions and income distribution</b>	
Real estate taxes . . . . .	\$2,250
Attorney's fee . . . . .	325
Exemption . . . . .	600
Distribution . . . . .	<u>2,000</u>
<b>Taxable income</b> . . . . .	<b>\$10,025</b>

The estate had a net capital gain and taxable income, so you use Part V of Schedule D (Form

1041) and the Schedule D Tax Worksheet to figure the tax, \$2,826, for 2002.

**Note.** For purpose of this example, we have illustrated the filled-in worksheet. You would not file the worksheet with the return. You would keep the worksheet for your records.

**2003 income tax return for estate.** On January 7, 2003, you receive a dividend check from the XYZ Company for \$500. You also have interest posted to the savings account in January totaling \$350. On January 28, 2003, you make a final accounting to the court and obtain permission to close the estate. In the accounting, you list \$1,650 as the balance of the expense of administering the estate.

You advise the court that you plan to pay \$5,000 to Hometown Church, under the provisions of the will, and that you will distribute the balance of the property to your mother, the remaining beneficiary.

**Gross income.** After making the distributions already described, you can wind up the affairs of the estate. The gross income of the estate for 2003 is more than \$600, so you must file an income tax return, Form 1041, for 2003 (not shown). The estate's gross income for 2003 is \$850 (dividends \$500 and interest \$350).

**Deductions.** After making the following computations, you determine that none of the distributions made to your mother must be included in her taxable income for 2003.

<b>Gross income for 2003:</b>	
Dividends . . . . .	\$500
Interest . . . . .	<u>350</u>
	\$850

<b>Less deductions:</b>	
Administration expense . . . . .	<u>\$1,650</u>
<b>Loss</b> . . . . .	<b><u>(\$800)</u></b>

Note that because the contribution of \$5,000 to Hometown Church was not required under the terms of the will to be paid out of the gross income of the estate, it is not deductible and was not included in the computation.

The estate had no distributable net income in 2003, so none of the distributions made to your mother have to be included in her gross income. Furthermore, because the estate in the year of termination had deductions in excess of its gross income, the excess of \$800 will be allowed as a miscellaneous itemized deduction subject to the 2%-of-adjusted-gross-income limit to your mother on her individual return for the year 2003, if she itemizes deductions.

**Termination of estate.** You have made the final distribution of the assets of the estate and you are now ready to terminate the estate. You must notify the IRS, in writing, that the estate has been terminated and that all of the assets have been distributed to the beneficiaries. Form 56 can be used for this purpose. Be sure to report the termination to the IRS office where you filed Form 56 and to include the employer identification number on this notification.

Form 1040

Department of the Treasury—Internal Revenue Service U.S. Individual Income Tax Return 2002

IRS Use Only—Do not write or staple in this space.

Label

(See instructions on page 21.)

Use the IRS label.

Otherwise, please print or type.

Presidential Election Campaign (See page 21.)

Label Here

For the year Jan. 1-Dec. 31, 2002, or other tax year beginning , 2002, ending , 20
Your first name and initial Last name
John R. Smith
If a joint return, spouse's first name and initial Last name
Mary L. Smith
Home address (number and street). If you have a P.O. box, see page 21. Apt. no.
6406 Mayflower St.
City, town or post office, state, and ZIP code. If you have a foreign address, see page 21.
Juneville, ME 00000

OMB No. 1545-0074

Your social security number

234 00 7890

Spouse's social security number

567 00 0123

Important!

You must enter your SSN(s) above.

You Spouse
Yes No Yes No

Filing Status

Check only one box.

- 1 Single
2 Married filing jointly (even if only one had income)
3 Married filing separately. Enter spouse's SSN above and full name here.
4 Head of household (with qualifying person). (See page 21.) If the qualifying person is a child but not your dependent, enter this child's name here.
5 Qualifying widow(er) with dependent child (year spouse died). (See page 21.)

Exemptions

6a Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 6a

b Spouse

Table with 4 columns: (1) First name, Last name, (2) Dependent's social security number, (3) Dependent's relationship to you, (4) if qualifying child for child tax credit (see page 22)

If more than five dependents, see page 22.

No. of boxes checked on 6a and 6b: 2
No. of children on 6c who:
- lived with you
- did not live with you due to divorce or separation (see page 22)
Dependents on 6c not entered above
Add numbers on lines above: 2

Income

Attach Forms W-2 and W-2G here. Also attach Form(s) 1099-R if tax was withheld.

If you did not get a W-2, see page 23.

Enclose, but do not attach, any payment. Also, please use Form 1040-V.

Table with 2 columns: Description, Amount. Rows include: 7 Wages, salaries, tips, etc. Attach Form(s) W-2 (11,000); 8a Taxable interest. Attach Schedule B if required (3,140); 9 Ordinary dividends. Attach Schedule B if required; 10 Taxable refunds, credits, or offsets of state and local income taxes; 11 Alimony received; 12 Business income or (loss). Attach Schedule C or C-EZ; 13 Capital gain or (loss). Attach Schedule D if required. If not required, check here; 14 Other gains or (losses). Attach Form 4797; 15a IRA distributions; 15b Taxable amount (see page 25); 16a Pensions and annuities; 16b Taxable amount (see page 25); 17 Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E (8,183); 18 Farm income or (loss). Attach Schedule F; 19 Unemployment compensation; 20a Social security benefits; 20b Taxable amount (see page 27); 21 Other income. List type and amount (see page 29); 22 Add the amounts in the far right column for lines 7 through 21. This is your total income (22,323)

Adjusted Gross Income

Table with 2 columns: Description, Amount. Rows include: 23 Educator expenses (see page 29); 24 IRA deduction (see page 29); 25 Student loan interest deduction (see page 31); 26 Tuition and fees deduction (see page 32); 27 Archer MSA deduction. Attach Form 8853; 28 Moving expenses. Attach Form 3903; 29 One-half of self-employment tax. Attach Schedule SE; 30 Self-employed health insurance deduction (see page 33); 31 Self-employed SEP, SIMPLE, and qualified plans; 32 Penalty on early withdrawal of savings; 33a Alimony paid; b Recipient's SSN; 34 Add lines 23 through 33a; 35 Subtract line 34 from line 22. This is your adjusted gross income (22,323)

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 76.

Cat. No. 11320B

Form 1040 (2002)











**SCHEDULE E  
(Form 1040)**

Department of the Treasury  
Internal Revenue Service

**Supplemental Income and Loss**

(From rental real estate, royalties, partnerships,  
S corporations, estates, trusts, REMICs, etc.)

OMB No. 1545-0074

**2002**

Attachment  
Sequence No. **13**

▶ Attach to Form 1040 or Form 1041. ▶ See Instructions for Schedule E (Form 1040).

Name(s) shown on return

John R. (Deceased) & Mary L. Smith

Your social security number

234 00 7890

**Part I Income or Loss From Rental Real Estate and Royalties** Note. If you are in the business of renting personal property, use Schedule C or C-EZ (see page E-3). Report farm rental income or loss from Form 4835 on page 2, line 39.

1	Show the kind and location of each rental real estate property:	2	For each rental real estate property listed on line 1, did you or your family use it during the tax year for personal purposes for more than the greater of:	Yes	No
A	House, 137 Main Street Juneville, ME 00000		<ul style="list-style-type: none"> <li>• 14 days or</li> <li>• 10% of the total days rented at fair rental value?</li> </ul> (See page E-3.)	A	✓
B				B	
C				C	

Income:	Properties			Totals (Add columns A, B, and C.)
	A	B	C	
3 Rents received . . . . .	3 12,000			3 12,000
4 Royalties received . . . . .	4			4
<b>Expenses:</b>				
5 Advertising . . . . .	5			
6 Auto and travel (see page E-4) . . . . .	6			
7 Cleaning and maintenance. . . . .	7			
8 Commissions . . . . .	8			
9 Insurance . . . . .	9 260			
10 Legal and other professional fees . . . . .	10			
11 Management fees. . . . .	11			
12 Mortgage interest paid to banks, etc. (see page E-4) . . . . .	12 410			12 410
13 Other interest . . . . .	13			
14 Repairs . . . . .	14 350			
15 Supplies . . . . .	15			
16 Taxes . . . . .	16 700			
17 Utilities . . . . .	17			
18 Other (list) ▶ . . . . .	18			
19 Add lines 5 through 18 . . . . .	19 1,720			19 1,720
20 Depreciation expense or depletion (see page E-4). . . . .	20 2,097			20 2,097
21 Total expenses. Add lines 19 and 20 . . . . .	21 3,817			
22 Income or (loss) from rental real estate or royalty properties. Subtract line 21 from line 3 (rents) or line 4 (royalties). If the result is a (loss), see page E-5 to find out if you must file Form 6198. . . . .	22 8,183			
23 Deductible rental real estate loss. <b>Caution.</b> Your rental real estate loss on line 22 may be limited. See page E-5 to find out if you must file Form 8582. Real estate professionals must complete line 42 on page 2 . . . . .	23 ( ) ( ) ( )			
24 <b>Income.</b> Add positive amounts shown on line 22. <b>Do not</b> include any losses. . . . .	24			24 8,183
25 <b>Losses.</b> Add royalty losses from line 22 and rental real estate losses from line 23. Enter total losses here . . . . .	25 ( ) ( ) ( )			
26 <b>Total rental real estate and royalty income or (loss).</b> Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 39 on page 2 do not apply to you, also enter this amount on Form 1040, line 17. Otherwise, include this amount in the total on line 40 on page 2 . . . . .	26			26 8,183

**Depreciation and Amortization**  
**(Including Information on Listed Property)**

Department of the Treasury  
Internal Revenue Service

▶ See separate instructions. ▶ Attach to your tax return.

**2002**

Attachment  
Sequence No. **67**

Name(s) shown on return

John R. (Deceased) & Mary L. Smith

Business or activity to which this form relates

Identifying number  
234-00-7890

**Part I Election To Expense Certain Tangible Property Under Section 179**

**Note:** If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount. See page 2 of the instructions for a higher limit for certain businesses . . . . .	1	\$24,000
2	Total cost of section 179 property placed in service (see page 2 of the instructions) . . . . .	2	
3	Threshold cost of section 179 property before reduction in limitation . . . . .	3	\$200,000
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see page 2 of the instructions . . . . .	5	
<b>(a) Description of property</b>		<b>(b) Cost (business use only)</b>	<b>(c) Elected cost</b>
6			
7	Listed property. Enter the amount from line 29 . . . . .	7	
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7 . . . . .	8	
9	Tentative deduction. Enter the <b>smaller</b> of line 5 or line 8 . . . . .	9	
10	Carryover of disallowed deduction from line 13 of your 2001 Form 4562. . . . .	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5 (see instructions)	11	
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11 . . . . .	12	
13	Carryover of disallowed deduction to 2003. Add lines 9 and 10, less line 12 ▶	13	

**Note:** Do not use Part II or Part III below for listed property. Instead, use Part V.

**Part II Special Depreciation Allowance and Other Depreciation (Do not include listed property.)**

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year (see page 3 of the instructions) . . . . .	14	
15	Property subject to section 168(f)(1) election (see page 4 of the instructions) . . . . .	15	
16	Other depreciation (including ACRS) (see page 4 of the instructions) . . . . .	16	

**Part III MACRS Depreciation (Do not include listed property.) (See page 4 of the instructions.)**

**Section A**

17	MACRS deductions for assets placed in service in tax years beginning before 2002 . . . . .	17	1,211
18	If you are electing under section 168(i)(4) to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ <input type="checkbox"/>		

**Section B—Assets Placed in Service During 2002 Tax Year Using the General Depreciation System**

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental property			27.5 yrs.	MM	S/L	
i Nonresidential real property			39 yrs.	MM	S/L	

**Section C—Assets Placed in Service During 2002 Tax Year Using the Alternative Depreciation System**

20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year	4-02	50,000	40 yrs.	MM	S/L	886

**Part IV Summary (see page 6 of the instructions)**

21	Listed property. Enter amount from line 28. . . . .	21	
22	<b>Total.</b> Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instr.	22	2,097
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs . . . . .	23	

A Type of entity: (see instr.) For calendar year 2002 or fiscal year beginning , 2002, and ending , 20
Decedent's estate
Simple trust
Complex trust
Qualified disability trust
ESBT (S portion only)
Grantor type trust
Bankruptcy estate—Ch. 7
Bankruptcy estate—Ch. 11
Pooled income fund
B Number of Schedules K-1 attached (see instructions) 1
City or town, state, and ZIP code Juneville, ME 00000
C Employer identification number 10 0123456
D Date entity created 4-9-02
E Nonexempt charitable and split-interest trusts, check applicable boxes (see page 11 of the instructions):
Described in section 4947(a)(1)
Not a private foundation
Described in section 4947(a)(2)

F Check applicable boxes:
Initial return
Change in fiduciary's name
Final return
Change in fiduciary's address
Amended return
Change in fiduciary's address
G Pooled mortgage account (see page 12 of the instructions):
Bought
Sold
Date:

Income table with 9 rows: 1 Interest income 2,250; 2 Ordinary dividends 750; 3 Business income or (loss); 4 Capital gain or (loss) 200; 5 Rents, royalties, partnerships, other estates and trusts, etc.; 6 Farm income or (loss); 7 Ordinary gain or (loss); 8 Other income. List type and amount IRD Salary and vacation pay 12,000; 9 Total income. Combine lines 1 through 8 15,200

Deductions table with 12 rows: 10 Interest. Check if Form 4952 is attached; 11 Taxes 2,250; 12 Fiduciary fees; 13 Charitable deduction (from Schedule A, line 7); 14 Attorney, accountant, and return preparer fees 325; 15a Other deductions not subject to the 2% floor; 15b Allowable miscellaneous itemized deductions subject to the 2% floor; 16 Total. Add lines 10 through 15b 2,575; 17 Adjusted total income or (loss). Subtract line 16 from line 9. Enter here and on Schedule B, line 1 12,625; 18 Income distribution deduction (from Schedule B, line 15) (attach Schedules K-1 (Form 1041)) 2,000; 19 Estate tax deduction (including certain generation-skipping taxes) (attach computation); 20 Exemption 600; 21 Total deductions. Add lines 18 through 20 2,600

Tax and Payments table with 9 rows: 22 Taxable income. Subtract line 21 from line 17. If a loss, see page 17 of the instructions 10,025; 23 Total tax (from Schedule G, line 7) 2,826; 24a Payments: a 2002 estimated tax payments and amount applied from 2001 return; 24b Estimated tax payments allocated to beneficiaries (from Form 1041-T); 24c Subtract line 24b from line 24a; 24d Tax paid with extension of time to file: Form 2758 Form 8736 Form 8800; 24e Federal income tax withheld. If any is from Form(s) 1099, check; 24h Other payments: f Form 2439; g Form 4136; Total; 25 Total payments. Add lines 24c through 24e, and 24h; 26 Estimated tax penalty (see page 17 of the instructions); 27 Tax due. If line 25 is smaller than the total of lines 23 and 26, enter amount owed 2,826; 28 Overpayment. If line 25 is larger than the total of lines 23 and 26, enter amount overpaid; 29 Amount of line 28 to be: a Credited to 2003 estimated tax; b Refunded

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign Here Charles R. Smith, Executor 3-24-03
Signature of fiduciary or officer representing fiduciary Date EIN of fiduciary if a financial institution
May the IRS discuss this return with the preparer shown below (see instr.)? Yes No

Paid Preparer's Use Only
Preparer's signature
Date
Check if self-employed
Preparer's SSN or PTIN
Firm's name (or yours if self-employed), address, and ZIP code
EIN
Phone no.



**Schedule A Charitable Deduction.** Do not complete for a simple trust or a pooled income fund.

1	Amounts paid or permanently set aside for charitable purposes from gross income (see page 18)	1	
2	Tax-exempt income allocable to charitable contributions (see page 18 of the instructions)	2	
3	Subtract line 2 from line 1	3	
4	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes	4	
5	Add lines 3 and 4	5	
6	Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes (see page 18 of the instructions)	6	
7	<b>Charitable deduction.</b> Subtract line 6 from line 5. Enter here and on page 1, line 13	7	

**Schedule B Income Distribution Deduction**

1	Adjusted total income (see page 18 of the instructions)	1	12,625
2	Adjusted tax-exempt interest	2	
3	Total net gain from Schedule D (Form 1041), line 16, column (1) (see page 19 of the instructions)	3	
4	Enter amount from Schedule A, line 4 (reduced by any allocable section 1202 exclusion)	4	
5	Capital gains for the tax year included on Schedule A, line 1 (see page 19 of the instructions)	5	
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6	(200)
7	<b>Distributable net income (DNI).</b> Combine lines 1 through 6. If zero or less, enter -0-	7	12,425
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8	
9	Income required to be distributed currently	9	
10	Other amounts paid, credited, or otherwise required to be distributed	10	2,000
11	Total distributions. Add lines 9 and 10. If greater than line 8, see page 19 of the instructions	11	2,000
12	Enter the amount of tax-exempt income included on line 11	12	
13	Tentative income distribution deduction. Subtract line 12 from line 11	13	2,000
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14	12,425
15	<b>Income distribution deduction.</b> Enter the smaller of line 13 or line 14 here and on page 1, line 18	15	2,000

**Schedule G Tax Computation** (see page 20 of the instructions)

1	<b>Tax:</b> a <input type="checkbox"/> Tax rate schedule or <input checked="" type="checkbox"/> Schedule D (Form 1041)	1a	2,826	
	b Tax on lump-sum distributions (attach Form 4972)	1b		
	c Alternative minimum tax (from Schedule I, line 56)	1c		
	d <b>Total.</b> Add lines 1a through 1c	1d	2,826	
2a	Foreign tax credit (attach Form 1116)	2a		
b	Other nonbusiness credits (attach schedule)	2b		
c	General business credit. Enter here and check which forms are attached: <input type="checkbox"/> Form 3800 <input type="checkbox"/> Forms (specify) ▶	2c		
d	Credit for prior year minimum tax (attach Form 8801)	2d		
3	<b>Total credits.</b> Add lines 2a through 2d	3		
4	Subtract line 3 from line 1d. If zero or less, enter -0-	4	2,826	
5	Recapture taxes. Check if from: <input type="checkbox"/> Form 4255 <input type="checkbox"/> Form 8611.	5	-0-	
6	Household employment taxes. Attach Schedule H (Form 1040)	6		
7	<b>Total tax.</b> Add lines 4 through 6. Enter here and on page 1, line 23	7	2,826	

**Other Information**

	Yes	No
1 Did the estate or trust receive tax-exempt income? If "Yes," attach a computation of the allocation of expenses Enter the amount of tax-exempt interest income and exempt-interest dividends ▶ \$ .....		✓
2 Did the estate or trust receive all or any part of the earnings (salary, wages, and other compensation) of any individual by reason of a contract assignment or similar arrangement?		✓
3 At any time during calendar year 2002, did the estate or trust have an interest in or a signature or other authority over a bank, securities, or other financial account in a foreign country? See page 21 of the instructions for exceptions and filing requirements for Form TD F 90-22.1. If "Yes," enter the name of the foreign country ▶ .....		✓
4 During the tax year, did the estate or trust receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," the estate or trust may have to file Form 3520. See page 21 of the instructions		✓
5 Did the estate or trust receive, or pay, any qualified residence interest on seller-provided financing? If "Yes," see page 21 for required attachment		✓
6 If this is an estate or a complex trust making the section 663(b) election, check here (see page 21) . . . ▶ <input type="checkbox"/>		
7 To make a section 643(e)(3) election, attach Schedule D (Form 1041), and check here (see page 21) . . . ▶ <input type="checkbox"/>		
8 If the decedent's estate has been open for more than 2 years, attach an explanation for the delay in closing the estate, and check here ▶ <input type="checkbox"/>		
9 Are any present or future trust beneficiaries skip persons? See page 21 of the instructions		✓

**Schedule I Alternative Minimum Tax** (see pages 21 through 27 of the instructions)

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

1	Adjusted total income or (loss) (from page 1, line 17)		1	12,625	
2	Interest		2		
3	Taxes		3	2,250	
4	Miscellaneous itemized deductions (from page 1, line 15b)		4		
5	Refund of taxes		5	( )	
6	Depletion (difference between regular tax and AMT)		6		
7	Net operating loss deduction. Enter as a positive amount		7		
8	Interest from specified private activity bonds exempt from the regular tax		8		
9	Qualified small business stock (42% of gain excluded under section 1202)		9		
10	Exercise of incentive stock options (excess of AMT income over regular tax income)		10		
11	Other estates and trusts (amount from Schedule K-1 (Form 1041), line 9)		11		
12	Electing large partnerships (amount from Schedule K-1 (Form 1065-B), box 6)		12		
13	Disposition of property (difference between AMT and regular tax gain or loss)		13		
14	Depreciation on assets placed in service after 1986 (difference between regular tax and AMT)		14		
15	Passive activities (difference between AMT and regular tax income or loss)		15		
16	Loss limitations (difference between AMT and regular tax income or loss)		16		
17	Circulation costs (difference between regular tax and AMT)		17		
18	Long-term contracts (difference between AMT and regular tax income)		18		
19	Mining costs (difference between regular tax and AMT)		19		
20	Research and experimental costs (difference between regular tax and AMT)		20		
21	Income from certain installment sales before January 1, 1987		21	( )	
22	Intangible drilling costs preference		22		
23	Other adjustments, including income-based related adjustments		23		
24	Alternative tax net operating loss deduction		24	( )	
25	Adjusted alternative minimum taxable income. Combine lines 1 through 24		25	14,875	
<b>Note:</b> Complete Part II below before going to line 26.					
26	Income distribution deduction from line 44 below	26	2,000		
27	Estate tax deduction (from page 1, line 19)	27			
28	Add lines 26 and 27		28	2,000	
29	Estate's or trust's share of alternative minimum taxable income. Subtract line 28 from line 25.		29	12,875	

If line 29 is:

- \$22,500 or less, stop here and enter -0- on Schedule G, line 1c. The estate or trust is not liable for the alternative minimum tax.
- Over \$22,500, but less than \$165,000, go to line 45.
- \$165,000 or more, enter the amount from line 29 on line 51 and go to line 52.

**Part II—Income Distribution Deduction on a Minimum Tax Basis**

30	Adjusted alternative minimum taxable income (see page 25 of the instructions)	30	14,875	
31	Adjusted tax-exempt interest (other than amounts included on line 8)	31		
32	Total net gain from Schedule D (Form 1041), line 16, column (1). If a loss, enter -0-	32		
33	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes (from Schedule A, line 4)	33		
34	Capital gains paid or permanently set aside for charitable purposes from gross income (see page 26 of the instructions)	34		
35	Capital gains computed on a minimum tax basis included on line 25	35	( 200 )	
36	Capital losses computed on a minimum tax basis included on line 25. Enter as a positive amount	36		
37	Distributable net alternative minimum taxable income (DNAMTI). Combine lines 30 through 36. If zero or less, enter -0-	37	14,675	
38	Income required to be distributed currently (from Schedule B, line 9)	38		
39	Other amounts paid, credited, or otherwise required to be distributed (from Schedule B, line 10)	39	2,000	
40	Total distributions. Add lines 38 and 39	40	2,000	
41	Tax-exempt income included on line 40 (other than amounts included on line 8)	41		
42	Tentative income distribution deduction on a minimum tax basis. Subtract line 41 from line 40.	42	2,000	
43	Tentative income distribution deduction on a minimum tax basis. Subtract line 31 from line 37. If zero or less, enter -0-	43	14,675	
44	<b>Income distribution deduction on a minimum tax basis.</b> Enter the smaller of line 42 or line 43. Enter here and on line 26	44	2,000	

**SCHEDULE D  
(Form 1041)**

Department of the Treasury  
Internal Revenue Service

**Capital Gains and Losses**

▶ **Attach to Form 1041 (or Form 5227). See the separate instructions for Form 1041 (or Form 5227).**

OMB No. 1545-0092

**2002**

Name of estate or trust

Estate of John R. Smith

Employer identification number

10 0123456

**Note:** Form 5227 filers need to complete **only** Parts I and II.

**Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less**

(a) Description of property (Example, 100 shares 7% preferred of "Z" Co.)	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Sales price	(e) Cost or other basis (see page 29)	(f) Gain or (Loss) (col. (d) less col. (e))	
1						
2	Short-term capital gain or (loss) from Forms 4684, 6252, 6781, and 8824				2	
3	Net short-term gain or (loss) from partnerships, S corporations, and other estates or trusts				3	
4	Short-term capital loss carryover. Enter the amount, if any, from line 9 of the 2001 Capital Loss Carryover Worksheet				4	( )
5	<b>Net short-term gain or (loss).</b> Combine lines 1 through 4 in column (f). Enter here and on line 14 below				5	

**Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year**

(a) Description of property (Example, 100 shares 7% preferred of "Z" Co.)	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Sales price	(e) Cost or other basis (see page 29)	(f) Gain or (Loss) (col. (d) less col. (e))	(g) 28% Rate Gain or (Loss) *(see instr. below)
6	Coin Collection	4-9-02	3,000	2,800	200	200
7	Long-term capital gain or (loss) from Forms 2439, 4684, 6252, 6781, and 8824				7	
8	Net long-term gain or (loss) from partnerships, S corporations, and other estates or trusts				8	
9	Capital gain distributions				9	
10	Gain from Form 4797, Part I				10	
11	Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 14, of the 2001 Capital Loss Carryover Worksheet				11	( ) ( )
12	Combine lines 6 through 11 in column (g)				12	200
13	<b>Net long-term gain or (loss).</b> Combine lines 6 through 11 in column (f). Enter here and on line 15 below				13	200

\*28% rate gain or loss includes all "collectibles gains and losses" (as defined on page 30 of the instructions) and up to 50% of the eligible gain on qualified small business stock (see page 28 of the instructions).

**Part III Summary of Parts I and II**

	(1) Beneficiaries' (see page 30)	(2) Estate's or trust's	(3) Total
14 <b>Net short-term gain or (loss)</b> (from line 5 above)	14		
15 <b>Net long-term gain or (loss):</b>			
a Total for year (from line 13 above)	15a	200	200
b 28% rate gain or (loss) (from line 12 above)	15b	200	200
c Qualified 5-year gain	15c		
d Unrecaptured section 1250 gain (see line 17 of the worksheet on page 31)	15d		
16 <b>Total net gain or (loss).</b> Combine lines 14 and 15a	16	200	200

**Note:** If line 16, column (3), is a net gain, enter the gain on Form 1041, line 4. If lines 15a and 16, column (2), are net gains, go to Part V, and do not complete Part IV. If line 16, column (3), is a net loss, complete Part IV and the **Capital Loss Carryover Worksheet**, as necessary.



**Part IV Capital Loss Limitation**

**17** Enter here and enter as a (loss) on Form 1041, line 4, the **smaller** of:  
**a** The loss on line 16, column (3) **or**  
**b** \$3,000 . . . . . **17** (                      )

If the loss on line 16, column (3), is more than \$3,000, **or** if Form 1041, page 1, line 22, is a loss, complete the **Capital Loss Carryover Worksheet** on page 32 of the instructions to determine your capital loss carryover.

**Part V Tax Computation Using Maximum Capital Gains Rates** (Complete this part **only** if both lines 15a and 16 in column (2) are gains, and Form 1041, line 22 is more than zero.)

**Note:** If line 15b, column (2) or line 15d, column (2) is more than zero, complete the worksheet on page 34 of the instructions to figure the amount to enter on lines 20 and 38 below and skip all other lines below. Otherwise, go to line 18.

<b>18</b>	Enter taxable income from Form 1041, line 22 . . . . .	<b>18</b>			
<b>19</b>	Enter the <b>smaller</b> of line 15a or 16 in column (2) . . . . .	<b>19</b>			
<b>20</b>	If the estate or trust is filing Form 4952, enter the amount from line 4e; otherwise, enter -0- ▶	<b>20</b>	-0-		
<b>21</b>	Subtract line 20 from line 19. If zero or less, enter -0-	<b>21</b>			
<b>22</b>	Subtract line 21 from line 18. If zero or less, enter -0-	<b>22</b>			
<b>23</b>	Figure the tax on the amount on line 22. Use the 2002 Tax Rate Schedule on page 20 of the instructions . . . . .	<b>23</b>			
<b>24</b>	Enter the <b>smaller</b> of the amount on line 18 or \$1,850 . . . . .	<b>24</b>			
<b>If line 24 is greater than line 22, go to line 25. Otherwise, skip lines 25 through 31 and go to line 32.</b>					
<b>25</b>	Enter the amount from line 22 . . . . .	<b>25</b>			
<b>26</b>	Subtract line 25 from line 24. If zero or less, enter -0- and go to line 32.	<b>26</b>			
<b>27</b>	Enter the estate's or trust's allocable portion of qualified 5-year gain, if any, from line 15c, column (2) . . . . .	<b>27</b>			
<b>28</b>	Enter the <b>smaller</b> of line 26 or line 27 . . . . .	<b>28</b>			
<b>29</b>	Multiply line 28 by 8% (.08) . . . . .	<b>29</b>			
<b>30</b>	Subtract line 28 from line 26 . . . . .	<b>30</b>			
<b>31</b>	Multiply line 30 by 10% (.10) . . . . .	<b>31</b>			
<b>If the amounts on lines 21 and 26 are the same, skip lines 32 through 35 and go to line 36.</b>					
<b>32</b>	Enter the <b>smaller</b> of line 18 or line 21 . . . . .	<b>32</b>			
<b>33</b>	Enter the amount, if any, from line 26 . . . . .	<b>33</b>			
<b>34</b>	Subtract line 33 from line 32 . . . . .	<b>34</b>			
<b>35</b>	Multiply line 34 by 20% (.20) . . . . .	<b>35</b>			
<b>36</b>	Add lines 23, 29, 31, and 35 . . . . .	<b>36</b>			
<b>37</b>	Figure the tax on the amount on line 18. Use the 2002 Tax Rate Schedule on page 20 of the instructions . . . . .	<b>37</b>			
<b>38</b>	<b>Tax on all taxable income (including capital gains).</b> Enter the <b>smaller</b> of line 36 or line 37 here and on line 1a of Schedule G, Form 1041 . . . . .	<b>38</b>			2,826

**SCHEDULE K-1  
(Form 1041)**

**Beneficiary's Share of Income, Deductions, Credits, etc.**

OMB No. 1545-0092

for the calendar year 2002, or fiscal year

**2002**

Department of the Treasury  
Internal Revenue Service

beginning \_\_\_\_\_, 2002, ending \_\_\_\_\_, 20 \_\_\_\_\_

▶ **Complete a separate Schedule K-1 for each beneficiary.**

Name of trust or decedent's estate

Estate of John R. Smith

Amended K-1  
 Final K-1

**Beneficiary's identifying number ▶** 123-00-6789

**Estate's or trust's EIN ▶** 10 0123456

Beneficiary's name, address, and ZIP code

James Smith  
6407 Mayflower Street  
Juneville, ME 00000

Fiduciary's name, address, and ZIP code

Charles R. Smith, Executor  
6406 Mayflower Street  
Juneville, ME 00000

(a) Allocable share item		(b) Amount	(c) Calendar year 2002 Form 1040 filers enter the amounts in column (b) on:
<b>1</b> Interest . . . . .	<b>1</b>	300	Schedule B, Part I, line 1
<b>2</b> Ordinary dividends . . . . .	<b>2</b>	100	Schedule B, Part II, line 5
<b>3</b> Net short-term capital gain . . . . .	<b>3</b>		Schedule D, line 5
<b>4</b> Net long-term capital gain: <b>a</b> Total for year . . . . .	<b>4a</b>		Schedule D, line 12, column (f)
	<b>4b</b>		Schedule D, line 12, column (g)
<b>b</b> 28% rate gain . . . . .	<b>4c</b>		Line 5 of the worksheet for Schedule D, line 29
<b>c</b> Qualified 5-year gain . . . . .	<b>4c</b>		
<b>d</b> Unrecaptured section 1250 gain . . . . .	<b>4d</b>		Line 11 of the worksheet for Schedule D, line 19
<b>5a</b> Annuities, royalties, and other nonpassive income before directly apportioned deductions . . . . .	<b>5a</b>	1,600	Schedule E, Part III, column (f)
	<b>5b</b>		} Include on the applicable line of the appropriate tax form
	<b>5c</b>		
	<b>5d</b>		
<b>6a</b> Trade or business, rental real estate, and other rental income before directly apportioned deductions (see instructions) . . . . .	<b>6a</b>		
	<b>6b</b>		} Include on the applicable line of the appropriate tax form
	<b>6c</b>		
	<b>6d</b>		
<b>7</b> Income for minimum tax purposes . . . . .	<b>7</b>	2,000	
<b>8</b> Income for regular tax purposes (add lines 1, 2, 3, 4a, 5a, and 6a) . . . . .	<b>8</b>	2,000	
<b>9</b> Adjustment for minimum tax purposes (subtract line 8 from line 7)	<b>9</b>		Form 6251, line 14
<b>10</b> Estate tax deduction (including certain generation-skipping transfer taxes) . . . . .	<b>10</b>		Schedule A, line 27
<b>11</b> Foreign taxes . . . . .	<b>11</b>		Form 1040, line 45 or Schedule A, line 8
<b>12</b> Adjustments and tax preference items (itemize):			
<b>a</b> Accelerated depreciation . . . . .	<b>12a</b>		
<b>b</b> Depletion . . . . .	<b>12b</b>		
<b>c</b> Amortization . . . . .	<b>12c</b>		
<b>d</b> Exclusion items . . . . .	<b>12d</b>		
<b>13</b> Deductions in the final year of trust or decedent's estate:	<b>a</b> Excess deductions on termination (see instructions)	<b>13a</b>	Schedule A, line 22
	<b>b</b> Short-term capital loss carryover . . . . .	<b>13b</b> ( )	Schedule D, line 5
	<b>c</b> Long-term capital loss carryover . . . . .	<b>13c</b> ( )	Schedule D, line 12, columns (f) and (g)
	<b>d</b> Net operating loss (NOL) carryover for regular tax purposes	<b>13d</b> ( )	Form 1040, line 21
	<b>e</b> NOL carryover for minimum tax purposes . . . . .	<b>13e</b>	See the instructions for Form 6251, line 27
	<b>f</b> . . . . .	<b>13f</b>	} Include on the applicable line of the appropriate tax form
	<b>g</b> . . . . .	<b>13g</b>	
	<b>14</b> Other (itemize):	<b>a</b> Payments of estimated taxes credited to you . . . . .	<b>14a</b>
<b>b</b> Tax-exempt interest . . . . .		<b>14b</b>	Form 1040, line 8b
<b>c</b> . . . . .		<b>14c</b>	} Include on the applicable line of the appropriate tax form
<b>d</b> . . . . .		<b>14d</b>	
<b>e</b> . . . . .		<b>14e</b>	
<b>f</b> . . . . .		<b>14f</b>	
<b>g</b> . . . . .		<b>14g</b>	
<b>h</b> . . . . .		<b>14h</b>	

**Schedule D Tax Worksheet**

Keep for Your Records



**Complete this worksheet only if line 15b, column (2), or line 15d, column (2), of Schedule D is more than zero.** Otherwise, complete Part V of Schedule D to figure the estate's or trust's tax. **Exception: Do not** use Schedule D, Part V, or this worksheet to figure the estate's or trust's tax if line 15a, column (2), or line 16, column (2), of Schedule D or Form 1041, line 22, is zero or less; instead, see the instructions for Schedule G, line 1a of Form 1041.

1. Enter your taxable income from Form 1041, line 22 . . . . .	1.	10,025
2. Enter the <b>smaller</b> of line 15a or line 16 in column (2) of Schedule D . . . . .	2.	200
3. If you are filing Form 4952, enter the amount from line 4e of that form. Otherwise, enter -0-. <b>Also enter this amount on Schedule D, line 20</b> . . . . .	3.	-0-
4. Subtract line 3 from line 2. If zero or less, enter -0- . . . . .	4.	200
5. Combine lines 14 and 15b, column (2) of Schedule D. If zero or less, enter -0- . . . . .	5.	200
6. Enter the <b>smaller</b> of line 5 above or Schedule D, line 15b, column (2), but not less than zero . . . . .	6.	200
7. Enter the amount from Schedule D, line 15d, column (2) . . . . .	7.	-0-
8. Add lines 6 and 7 . . . . .	8.	200
9. Subtract line 8 from line 4. If zero or less, enter -0- . . . . .	9.	-0-
10. Subtract line 9 from line 1. If zero or less, enter -0- . . . . .	10.	10,025
11. Enter the <b>smaller</b> of:		
• The amount on line 1 or	11.	1,850
• \$1,850		
12. Enter the <b>smaller</b> of line 10 or line 11 . . . . .	12.	1,850
13. Subtract line 4 from line 1. If zero or less, enter -0- . . . . .	13.	9,825
14. Enter the <b>larger</b> of line 12 or line 13 . . . . .	▶ 14.	9,825
15. Figure the tax on the amount on line 14. Use the 2002 Tax Rate Schedule on page 20 . . . . .	15.	2,770
<b>If lines 11 and 12 are the same, skip lines 16 through 21 and go to line 22. Otherwise, go to line 16.</b>		
16. Subtract line 12 from line 11 . . . . .	▶ 16.	
17. Enter the estate's or trust's allocable portion of qualified 5-year gain, if any, from Schedule D, line 15c, column (2) . . . . .	17.	
18. Enter the <b>smaller</b> of line 16 above or line 17 above . . . . .	18.	
19. Multiply line 18 by 8% (.08) . . . . .	19.	
20. Subtract line 18 from line 16 . . . . .	20.	
21. Multiply line 20 by 10% (.10) . . . . .	21.	
<b>If lines 1 and 11 are the same, skip lines 22 through 34 and go to line 35. Otherwise, go to line 22.</b>		
22. Enter the <b>smaller</b> of line 1 or line 9 . . . . .	22.	-0-
23. Enter the amount from line 16. If blank, enter -0- . . . . .	23.	-0-
24. Subtract line 23 from line 22 . . . . .	▶ 24.	-0-
25. Multiply line 24 by 20% (.20) . . . . .	25.	-0-
<b>If line 7 is zero or blank, skip lines 26 through 31 and go to line 32. Otherwise, go to line 26.</b>		
26. Enter the <b>smaller</b> of line 4 or line 7 . . . . .	26.	
27. Add lines 4 and 14 . . . . .	27.	
28. Enter the amount from line 1 . . . . .	28.	
29. Subtract line 28 from line 27. If zero or less, enter -0- . . . . .	29.	
30. Subtract line 29 from line 26. If zero or less, enter -0- . . . . .	▶ 30.	
31. Multiply line 30 by 25% (.25) . . . . .	31.	
<b>If line 6 is zero, skip lines 32 through 34 and go to line 35. Otherwise, go to line 32.</b>		
32. Add lines 14, 16, 24, and 30 . . . . .	32.	9,825
33. Subtract line 32 from line 1 . . . . .	33.	200
34. Multiply line 33 by 28% (.28) . . . . .	34.	56
35. Add lines 15, 19, 21, 25, 31, and 34 . . . . .	35.	2,826
36. Figure the tax on the amount on line 1. Use the 2002 Tax Rate Schedule on page 20 . . . . .	36.	2,847
37. <b>Tax on all taxable income (including capital gains).</b> Enter the <b>smaller</b> of line 35 or line 36. Also, enter this amount on Schedule D, line 38, and line 1a of Schedule G, Form 1041 . . . . .	37.	2,826



**Table A. Checklist of Forms and Due Dates—For Executor, Administrator, or Personal Representative**

<b>Form No.</b>	<b>Title</b>	<b>Due Date</b>
SS-4	Application for Employer Identification Number	As soon as possible. The identification number must be included in returns, statements, and other documents.
56	Notice Concerning Fiduciary Relationship	As soon as all necessary information is available.*
706	United States Estate (and Generation-Skipping Transfer) Tax Return	9 months after date of decedent's death.
706-A	United States Additional Estate Tax Return	6 months after cessation or disposition of special-use valuation property.
706-CE	Certificate of payment of foreign Death Tax	9 months after decedent's death. To be filed with Form 706.
706-GS(D)	Generation-Skipping Transfer Tax Return for Distributions	See form instructions.
706-GS(D-1)	Notification of Distribution From a Generation-Skipping Trust	See form instructions.
706-GS(T)	Generation-Skipping Transfer Tax Return for Terminations	See form instructions.
706-NA	United States Estate (and Generation-Skipping Transfer) Tax Return, Estate of nonresident not a citizen of the United States	9 months after date of decedent's death.
712	Life Insurance Statement	Part I to be filed with estate tax return.
1040	U.S. Individual Income Tax Return	Generally, April 15th of the year after death.
1040NR	U.S. Nonresident Alien income Tax Return	See form instructions.
1041	U.S. Income Tax Return for Estates and Trusts	15th day of 4th month after end of estate's tax year.
1041-A	U.S. Information Return—Trust Accumulation of Charitable amounts	April 15th.
1041-T	Allocation of Estimated Tax Payments to Beneficiaries	65th day after end of estate's tax year.
1041-ES	Estimated Income Tax for Estates and Trusts	Generally, April 15, June 15, Sept. 15, and Jan. 15 for calendar-year filers.
1042	Annual Withholding Tax Return for U.S. Source Income of Foreign Persons	March 15th.
1042-S	Foreign Person's U.S. Source Income Subject to Withholding	March 15th.
1310	Statement of Person Claiming Refund Due a Deceased Taxpayer	See form instructions.
2758	Application for Extension of Time To File Certain Excise, Income, Information, and other Returns	Sufficiently early to permit IRS to consider the application and reply before the due date of Form 1041.
4768	Application for Extension of Time To File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes	Sufficiently early to permit IRS to consider the application and reply before the estate tax form due date.
4810	Request for Prompt Assessment under Internal Revenue Code Section 6501(d)	As soon as possible after filing Form 1040 or Form 1041.
8300	Report of Cash Payments Over \$10,000 Received in a Trade or Business	15th day after the date of the transaction.
8822	Change of Address	As soon as the address is changed.

\* A personal representative must report the termination of the estate, in writing, to the Internal Revenue Service. Form 56 can be used for this purpose.

Table B. **Worksheet To Reconcile Amounts Reported in Name of Decedent on Information Returns (Forms W-2, 1099-INT, 1099-DIV, etc.) (Keep for your records)**

Name of Decedent		Date of Death	Decedent's Social Security Number		
Name of Personal Representative, Executor, or Administrator		Estate's Employer Identification Number (If Any)			
Source (list each payer)	A Enter total amount shown on information return	B Enter part of amount in column A reportable on decedent's final return	C Amount reportable on estate's or beneficiary's income tax return (column A minus column B)	D Part of column C that is <i>income in respect of a decedent</i>	
<b>1. Wages</b>					
<b>2. Interest income</b>					
<b>3. Dividends</b>					
<b>4. State income tax refund</b>					
<b>5. Capital gains</b>					
<b>6. Pension income</b>					
<b>7. Rents, royalties</b>					
<b>8. Taxes withheld*</b>					
<b>9. Other items, such as social security, business and farm income or loss, unemployment compensation, etc.</b>					

\* List each withholding agent (employer, etc.)

## How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

**Contacting your Taxpayer Advocate.** If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1-877-777-4778**.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1-800-829-4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS*.

**Free tax services.** To find out what services are available, get Publication 910, *Guide to Free Tax Services*. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.



**Personal computer.** With your personal computer and modem, you can access the IRS on the Internet at [www.irs.gov](http://www.irs.gov). While visiting our web site, you can:

- See answers to frequently asked tax questions or request help by e-mail.
- Download forms and publications or search for forms and publications by topic or keyword.
- Order IRS products on-line.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive our electronic newsletters on hot tax issues and news.
- Learn about the benefits of filing electronically (IRS e-file).
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at [ftp.irs.gov](ftp://ftp.irs.gov).



**TaxFax Service.** Using the phone attached to your fax machine, you can receive forms and instructions by calling **703-368-9694**. Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedWorld Help Desk at **703-487-4608**.



**Phone.** Many services are available by phone.

- **Ordering forms, instructions, and publications.** Call **1-800-829-3676** to order current and prior year forms, instructions, and publications.
- **Asking tax questions.** Call the IRS Tax Help Line for Individuals with your tax questions at **1-800-829-1040**. Or, if your question pertains to an income tax return of an estate, call the Business and Specialty Tax Help Line at **1-800-829-4933**.
- **Solving problems.** Take advantage of Everyday Tax Solutions service by calling your local IRS office to set up an in-person appointment at your convenience. Check your local directory assistance or [www.irs.gov](http://www.irs.gov) for the numbers.
- **TTY/TDD equipment.** If you have access to TTY/TDD equipment, call **1-800-829-4059** to ask tax questions or to order forms and publications.
- **TeleTax topics.** Call **1-800-829-4477** to listen to pre-recorded messages covering various tax topics.

**Evaluating the quality of our telephone services.** To ensure that IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to sometimes listen in on or record telephone calls. Another is to ask some callers to complete a short survey at the end of the call.



**Walk-in.** Many products and services are available on a walk-in basis.

- **Products.** You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- **Services.** You can walk in to your local IRS office to ask tax questions or get help

with a tax problem. Now you can set up an appointment by calling your local IRS office number and, at the prompt, leaving a message requesting Everyday Tax Solutions help. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience.



**Mail.** You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- **Western part of U.S.:**  
Western Area Distribution Center  
Rancho Cordova, CA 95743-0001
- **Central part of U.S.:**  
Central Area Distribution Center  
P.O. Box 8903  
Bloomington, IL 61702-8903
- **Eastern part of U.S. and foreign addresses:**  
Eastern Area Distribution Center  
P.O. Box 85074  
Richmond, VA 23261-5074



**CD-ROM for tax products.** You can order IRS Publication 1796, *Federal Tax Products on CD-ROM*, and obtain:

- Current tax forms, instructions, and publications.
- Prior-year tax forms and instructions.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1-877-233-6767** or on the Internet at <http://www.irs.gov/cdorders>. The first release is available in early January and the final release is available in late February.



**CD-ROM for small businesses.** IRS Publication 3207, *Small Business Resource Guide*, is a must for every small business owner or any taxpayer about to start a business. This handy, interactive CD contains all the business tax forms, instructions and publications needed to successfully manage a business. In addition, the CD provides an abundance of other helpful information, such as how to prepare a business plan, finding financing for your business, and much more. The design of the CD makes finding information easy and quick and incorporates file formats and browsers that can be run on virtually any desktop or laptop computer.

It is available in March. You can get a free copy by calling **1-800-829-3676** or by visiting the website at [www.irs.gov/smallbiz](http://www.irs.gov/smallbiz).





<p><b>A</b></p> <p>Accelerated death benefits . . . . . 5, 12</p> <p>Archer MSA . . . . . 5, 11</p> <p>Assistance (See Tax help)</p> <hr/> <p><b>B</b></p> <p>Basis:</p> <p>Inherited property . . . . . 13</p> <p>Joint interest property . . . . . 13</p> <p>Qualified joint interest . . . . . 13</p> <p>Beneficiary:</p> <p>Basis of property . . . . . 13</p> <p>Character of distributions . . . . . 21</p> <p>Excess deductions . . . . . 23</p> <p>Income received . . . . . 14</p> <p>Liability, estate's income tax . . . . . 15</p> <p>Nonresident alien . . . . . 15</p> <p>Reporting distributions . . . . . 21</p> <p>Successor . . . . . 23</p> <p>Treatment of distributions . . . . . 20</p> <p>Unused loss carryovers . . . . . 22</p> <p>Bequest:</p> <p>Defined . . . . . 22</p> <p>Property received . . . . . 12</p> <hr/> <p><b>C</b></p> <p>Claim, credit or refund . . . . . 7</p> <p>Combat zone . . . . . 2</p> <p>Comments . . . . . 2</p> <p>Coverdell education savings account (ESA) . . . . . 5, 11</p> 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5</p> <p>Filing requirements . . . . . 4</p> <p>Income to include . . . . . 4</p> <p>Joint return . . . . . 4</p> <p>Name, address, and signature . . . . . 7</p> <p>Other taxes . . . . . 6</p> <p>Payments . . . . . 7</p> <p>When and where to file . . . . . 7</p> <p>Who must file . . . . . 4</p> <p>Form:</p> <p>1040NR . . . . . 4, 14</p> <p>1041 . . . . . 14</p> <p>1042 . . . . . 15</p> <p>1310 . . . . . 4</p> <p>4810 . . . . . 3</p> <p>56 . . . . . 3</p> <p>6251 . . . . . 7</p> <p>706 . . . . . 23</p> <p>SS-4 . . . . . 3</p> <p>Free tax services . . . . . 41</p> <p>Funeral expenses . . . . . 19</p> <hr/> <p><b>G</b></p> <p>Gift, property . . . . . 12</p>	<p><b>H</b></p> <p>Help (See Tax help)</p> <hr/> <p><b>I</b></p> <p>Identification number, application . . . . . 3</p> <p>Income:</p> <p>Community . . . . . 5</p> <p>Distributable net income . . . . . 17</p> <p>Distributed currently . . . . . 20</p> <p>Interest and dividend . . . . . 5</p> <p>Partnership, final return . . . . . 4</p> 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7</p> <p>More information (See Tax help)</p> <hr/> <p><b>N</b></p> <p>Notice of fiduciary relationship:</p> <p>Form 56 . . . . . 3</p> <p>Termination . . . . . 3</p> <hr/> <p><b>P</b></p> <p>Partnership income . . . . . 4, 9</p> <p>Penalty:</p> <p>Information returns . . . . . 15</p> <p>Substantial valuation misstatement . . . . . 13</p>	<p>Personal representative:</p> <p>Defined . . . . . 2</p> <p>Duties . . . . . 3</p> <p>Fees received . . . . . 3</p> <p>Penalty . . . . . 3</p> <p>Two or more . . . . . 15</p> <p>Prompt assessment, request . . . . . 3</p> <p>Public safety officers, death benefits . . . . . 14</p> <p>Publications (See Tax help)</p> <hr/> <p><b>R</b></p> <p>Refund:</p> <p>File for decedent . . . . . 4</p> <p>Military or terrorist action deaths . . . . . 7</p> <p>Release from liability . . . . . 3</p> <p>Return:</p> <p>Decedent's final . . . . . 4</p> <p>Estate's income tax . . . . . 14</p> <p>Information . . . . . 15</p> <p>Roth IRA . . . . . 11</p> <hr/> 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