WHO GETS WHAT?

How Trust Accounting Income Affects Distributions from Trusts and Estates

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Agenda

- Definition of TAI
- UPIA – Background
- Definition of “income” and “principal”
- Bond Income
- Accrued income
- Undistributed income
- Business Activity
- Rental Property
- Depreciation
- Entities
- Deferred Compensation, Annuities, IRAs
- Income Taxes
- Distributions from Estates and Trusts
- Other 1997 UPIA Provisions

Congratulations!!!

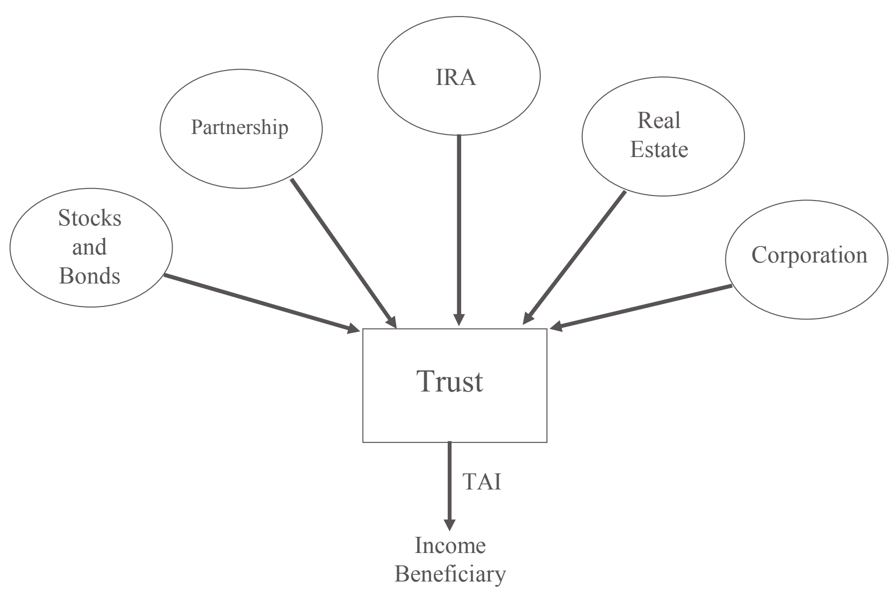
- You are all the income beneficiaries of an irrevocable trust that your recently deceased spouse set up for your benefit
- The trust is designed to qualify for the estate tax marital deduction
- After you die the remainder interest goes to your mother-in-law
- How do you determine how much you are entitled to from the trust?
  - You must compute the trust's trust accounting income (TAI)
    - TAI is what you get each year as long as your income interest lasts
    - Your mother in law is entitled to whatever is allocated to principal

Trusts Have Two Owners

- Two owners:
  - Owner of income interest
  - Owner of principal interest

What Assets Are In Your Trust?

- Stocks and bonds
- An interest in a partnership
- An IRA is payable to the trust
- Real estate subject to depreciation
- Liquidating distributions from a corporation
- The trust pays legal and accounting fees during the year



Example

- A simple trust receives the following income:
  - Interest - $2,500
  - Dividends - $5,000
  - Partnership - $20,000 cash distribution, K-1 shows $50,000 of taxable income
    - Assume not in liquidation and distribution is less than 20% of gross assets
  - IRA distribution - $20,000
  - Rental property – gross rental income of $40,000, rental expenses of $14,000 and depreciation of $6,000
  - Corporation liquidation proceeds - $100,000
    - Assume proceeds qualify for LTCG treatment
  - Trustee’s fees - $10,000

Trust Accounting Income (TAI)

- Defined in §643(b)
- “… the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law.”
- TAI = receipts allocated to income less disbursement allocated to income. 1997 UPIA §102(8)

How to Determine TAI

- First, read the governing instrument
- If not defined in governing instrument, see state law
  - In most cases, state law will have adopted some version of the Uniform Principal and Income Act (UPIA)
  - UPIA is a default law – if not covered by governing instrument, UPIA rules
    - Governing instrument trumps the UPIA – 1997 UPIA §103(a)(1)
- If neither the governing instrument nor the UPIA provides an answer, the item, by default, is allocated to principal. 1997 UPIA §103(a)(4)

TAI is Important

- Determines the amount to be distributed to income beneficiary from:
  - Simple trust
  - Marital trust
    - LE/GPOA under §2056(b)(5)
    - QTIP under §2056(b)(7)
  - NIMCRUT/NICRUT
  - QDOT
  - QSST
  - IRAs payable to trust

TAI v. TI v. DNI v. DNIAMT

- To complete a fiduciary income tax return, 4 different calculations are necessary:
  - Trust accounting income (TAI)
    - TAI is unrelated to and different from GAAP
  - Taxable income (TI)
  - Distributable net income (DNI)
  - Distributable net income on an alternative minimum tax basis

UPIA

- 3 versions: 1931, 1962 and 1997
  - Caution: UPIA provision differ from state to state – read the statute
- Adopted in 46 states (not adopted in IL, LA, GA and RI)
- Revised in 2008
  - Revisions adopted in 45 states
  - Being considered in 15 states

UPIA – Why It Is Needed

- Adoption of Uniform Prudent Investor Act
- Use of modern portfolio theory
  - Invest for total return
    - How the portfolio performed as a whole, regardless of the source e.g. income versus appreciation
      - Total return looks to capital appreciation as well as the annual return on investments
    - Modern portfolio theory of investing for total return replaced the traditional income and principal approach
    - The traditional approach generally focused on investing to produce income
    - The total return approach reduces the ordinary income available for distribution to the income beneficiary.
    - Results in investing most of the portfolio with equities (stocks) which pay little or no dividends but tend to appreciate in value over time, and investing less in fixed income securities (bonds)
      - » Result: leave income beneficiaries with less

1997 UPIA Solution – Power to Adjust

- 1997 UPIA §104 gives the trustee the power to adjust between income and principal
- Power to adjust must be applied in a manner that is "fair and reasonable" to all of the beneficiaries." 1997 UPIA §103(b)
- Power to adjust controls the income tax consequences as well as the calculation of TAI
- UPIA §104(b) lists 9 factors the trustee must consider in determining whether to use the power to adjust

1997 UPIA Solution – Power to Adjust

- 3 requirements to exercise power to adjust:
  - Trustee invests and manages trust assets as a prudent investor
  - Terms of trust describe the amount that may be distributed to a beneficiary by referring to the trust's "income"
  - Trustee determines he is unable to administer a trust impartially

1997 Definition of Income

- "Income" means money or property that a fiduciary receives as current return from a principal asset. 1997 UPIA §102(4). This includes:
  - Interest income
  - Dividends (to extent not included in principal e.g. liquidating dividends)
  - Net rental income
  - Half of legal, accounting and trustee fees 1997 UPIA §501(1) and (2)
  - Other ordinary expenses such as interest, ordinary repairs, regular recurring taxes assessed against principal and recurring premiums covering the loss of a principal asset. 1997 UPIA §501(3) and (4)
  - "Net income" is defined as "the total receipts allocated to income . . . minus the disbursements made from income during the accounting period."

Disbursements Allocated to Income

- Matching concept – allocating expenses to income that are related to receipts allocated to income
- One-half of fees for trustees, investment advisors and custodial services
- One-half of expenditures for accounting, judicial proceedings or other matters involving both income and remainder interest
- Recurring insurance premiums to cover loss of a principal asset or loss of income from asset use
- Income tax on receipts allocated to income
- Other ordinary expenses incurred to administer, manage or preserve trust property and distribute income such as:
  - Interest
  - Ordinary repairs
  - Regularly recurring taxes assessed against principal
  - Expenses of a proceeding primarily concerning the income interes
- 1997 UPIA §501(1)-(4)

1997 Definition of Principal

- "Principal" means property held in trust for distribution to a remainder beneficiary when the trust terminates. 1997 UPIA §102(10)
- Beginning balance of principal changes by:
  - Gain or loss from disposition of property – 1997 UPIA §404(2)
  - Increases due to liquidating distributions from "entities"- 1997 UPIA §401(c)(3) and 404(2)
  - Other principal receipts described in 1997 UPIA §404

Disbursements Allocated to Principal

- One-half of fees for trustees, investment advisors and custodial services
  - For trusts, decreases by half of legal, accounting and trustee fees – 1997 UPIA §502(a)(1)
  - For estates, the executor is given the discretion to charge legal, accounting and trustee fees to either income or principal or allocating partially to each. 1997 UPIA §201(2)(B)
- One-half of expenditures for accounting, judicial proceedings or other matters involving both income and remainder interest
- Trustee termination fees
- Principal payment of a trust debt
- Expenses of proceeding primarily involving principal
- Income taxes on receipts allocated to principal e.g. capital gains
- All transfer taxes i.e. estate, inheritance, GST, gift taxes, including interest and penalties
- Costs related to environmental matters
- 1997 UPIA §502(a)-(c)

	Income	**Principal**	**T I**	**DNI**
INCOME				
Interest	2,500		2,500	2,500
Dividends	5,000		5,000	5,000
P/ship Income				
IRA				
Rental Income				
Corp. Liq.				
EXPENSES				
Rental Exp.				
Depreciation				
Trustee's Fees				
Total				

Repayment of Money - Bonds

- Governed by 1997 UPIA §406
- Interest on debt is allocated to income
- Amount from sale, redemption or other disposition (even an increase in principal due to bonds issued at a discount) is allocated to principal if sale or redemption occurs more than one year after purchase or acquisition
  - If sale or redemption occurs within one year after purchase or acquisition, amounts received in excess of its purchase price or value when acquired is allocated to income

Amortization of Bond Premium and Discount

- Bond premiums and discounts are not taken into consideration in calculating TAI. 1997 UPIA §406.
- Actual coupon rate reflects income
- Reclassification is not made between interest income and the carrying value of the bond as the bondholder receives payments
  - Income account cheated for discount and principal account benefits
  - Principal account cheated for premium and income account benefits

Accrued Income

- Decedent dies 3/31/2010
- Assets held in revocable trust
- Trust holds bonds which pays $5,000 of interest semi-annually on April 1 and October 1
- Trust also holds stock with a $3,000 dividend payable to stockholder of record on March 28 payable on April 3
- How is this accrued income allocated between income and principal?

Accrued Income

- UPIA §302 – a periodic receipt that has a due date shall be treated as income if the due date occurs <u>after</u> the date of death and as principal if the due date is occurs <u>before</u> death
- A payment is periodic if it is paid at regular intervals
- Interest payment of bond is payable April 1 (<u>after</u> the date of death) so the accrued interest should be allocated to income
- Due date for dividend is the March 28 record date (<u>before</u> date of death) so the accrued income should be allocated to principal

Undistributed Income

- Who gets undistributed income when an income interest ends?
  - Undistributed income means net income received before the date on which the income interest ends
- Income beneficiary of trust or his estate is entitled to the undistributed income from the trust when the income beneficiary's interest ends
- Income beneficiary dies on March 31
- How is the undistributed income computed?

Undistributed Income

- UPIA §303 defines undistributed income as net income received before the date on which the income interest ends
- UPIA §301(d) says that an income interest ends on the day before an income beneficiary dies
- If the income beneficiary died on March 31, the income beneficiary's interest ended on March 30 and the undistributed income is the income received prior to March 30
- Income beneficiary who died March 31 is not entitled to $3,000 in dividends or $5,000 in interest because neither was received before March 31
- The same principal applies to expenses
  - Only expenses paid before March 30 would be included in the calculation of undistributed income

Business Activities Conducted by Trustee

- Trustee may, in his discretion, account for business income separately instead of accounting for it as part of the trust's accounting. 1997 UPIA §403(a)
  - Intended to apply to proprietorships
- The net cash receipts may be credited to income or principal as the trustee determines. 1997 UPIA §403(b)
- Sale of business assets other than in the normal course of business, result in such receipts being credited to principal. 1997 UPIA §403(b)
- Types of business activity:
  - Retail, manufacturing, service
  - Management of rental properties
  - Other traditional business activities

Rental Property

- Rental income is allocated to income. 1997 UPIA §405
  - Security deposits are allocated to principal
  - Transfer from income to principal may be appropriate under §504 to the extent some of the "rent" is a reimbursement for improvements

Depreciation

- Under 1997 UPIA §§503 and 103(b) charging depreciation against income is left to the discretion of the trustee

	Income	Principal	T I	DNI
INCOME				
Interest	2,500		2,500	2,500
Dividends	5,000		5,000	5,000
P/ship Income				
IRA				
Rental Income	40,000		40,000	40,000
Corp. Liq.				
EXPENSES				
Rental Exp.	(14,000)		(14,000)	(14,000)
Depreciation		(6,000)		
Trustee's Fees				
Total				

Entities

- An entity is any form of conducting business except sole proprietorships e.g. corporation, partnership, LLC, RIC, REIT, CTF
- Cash receipts from entities are income unless they are deemed in liquidation. 1997 UPIA §401(b)
  - If an entity (1) indicates the distribution is in partial liquidation or (2) distributes more than 20% of its gross assets (as of the year end), the distribution is deemed to be in liquidation. 1997 UPIA §401(d)
  - If deemed to be in liquidation, the receipt is considered principal
  - Cash received in partial liquidation is not taken into account as a distribution in partial liquidation to the extent it does not exceed the amount of income tax the trustee must pay on taxable income of the entity that distributes the money
  - Distributions between 10% and 20% of gross assets
    - Use §104 power to adjust to credit to principal e.g. sale of business assets or proceeds of a loan

Entities

- Trust portfolio consists of investment portfolio which is invested for growth and generates substantial capital gains but little interest and dividends.
  - Capital gains are principal
  - Interest and dividends are income

Entities

- Same as previous example except that trustee transfers the investment portfolio to a LLC, an entity
  - Cash distributions from the LLC are all income assuming they are not deemed to be in liquidation. 1997 UPIA §401(b)
  - Note that capital gains incurred by the investment portfolio inside the LLC and distributed in cash from the LLC to the trust are converted from principal to income
  - Distributions to the beneficiary will be mostly tax-free because capital gains are not generally included in DNI
  - Is this violation of the trustee's fiduciary duty?
    - Principal beneficiary not entitled to capital gain
    - Income beneficiary receives a tax free distribution
    - Tax on gain paid by trust but should be paid out of income rather than out of principal as is usually the case

Entities

- Partnership has gross assets of $500,000
- Distributes $95,000 in <u>property</u>
  - Allocated to principal because it was distributed in property
- Instead distributes $95,000 in <u>cash</u>
  - Allocated to income because it is less than 20% of total assets
- Instead distributes $115,000 of <u>cash</u>
  - Allocated to principal because it is greater than 20% of total assets

Entities

- Note: how the income is reported on the Schedule K-1 does not control how the items is allocated for TAI purposes.

	Income	Principal	T I	DNI
INCOME				
Interest	2,500		2,500	2,500
Dividends	5,000		5,000	5,000
P/ship Income	20,000		50,000	50,000
IRA				
Rental Income	40,000		40,000	40,000
Corp. Liq.				
EXPENSES				
Rental Exp.	(14,000)		(14,000)	(14,000)
Depreciation		(6,000)		
Trustee's Fees				
Total				

Deferred Compensation, Annuities, IRAs

- UPIA §409 – background
  - §409(b) – if you can track receipt as interest or dividend, that controls and it is allocated to income
    - If not, §409(c) controls
  - §409(c) contains default rule for distributions from retirement accounts
    - If mandatory distribution, 90% principal, 10% income
    - If no mandatory distribution, 100% principal
  - §409(d) "savings clause" – if trustee needs to allocate more of a distribution to income to qualify for the estate tax marital deduction, the trustee shall allocate to income the additional amount necessary to qualify for the marital deduction

Deferred Compensation, Annuities, IRAs

- Rev. Rul. 2006-26 – IRS calls "foul"
- Allocation of retirement fund payments pursuant to UPIA §409(c) and §409(d) does not constitute "income" of a trust for purpose of qualifying for the marital deduction
  - The 90%/10% rule and the 100% rule do not reflect the trust's actual TAI
- Makes §409 useless

Qualifying an IRA for the QTIP Election

- Rev. Rul. 2006-26 – deals with qualification for marital deduction where IRA payable to trust where state law has:
  - UPIA statute
  - Unitrust statute
  - Traditional definition of trust accounting income

  Rev. Rul. 2006-26 also applies to defined contribution plans
- Note: trust instrument states that spouse can require the trust and IRA to invest in productive assets and <u>spouse</u> has the right to compel the trustee to withdraw the IRA income each year and pay it to the spouse
  - The above language is CRITICAL to marital deduction qualification

Qualifying an IRA for the QTIP Election

- Must make QTIP election for both the trust and the IRA
- Rev. Rul. 2006-26 sets forth how to qualify an IRA payable to a QTIP trust for the marital deduction regardless of whether the state has adopted the UPIA, a unitrust statute or uses the traditional definition of TAI
- Must satisfy two issues:
  - Determine a reasonable level of accounting income
    - Rev. Rul. 2006-26 says the UPIA, unitrust statute and traditional concept of TAI could produce enough accounting income to satisfy the marital deduction rules
  - Make sure the spouse has the unqualified right at least annually to demand the QTIP distribute to him/her the income of the IRA

Rev. Rul. 2006-26 – UPIA Statute

- Determine total return of <u>trust</u> (exclusive of IRA) and allocate that amount between income and principal
  - Annually distribute the amount allocated to income to spouse
- Determine total return of <u>IRA</u> (exclusive of trust) and allocate that amount between income and principal
  - If spouse exercises his/her withdrawal power, the trustee must pay the income to the spouse
  - Rev. Rul. 2006-26 rejects the UPIA §409(c) 90/10 rule and §409(d) "savings" language
    - 90/10 rule doesn't reflect the actual income of the IRA

Rev. Rul. 2006-26 – Unitrust Statute

- Determine unitrust amount for <u>trust</u> (exclusive of IRA)
  - Annually distribute that to spouse
- Determine unitrust amount for <u>IRA</u> (exclusive of trust)
  - If spouse exercises his/her withdrawal power, distribute that amount to the spouse

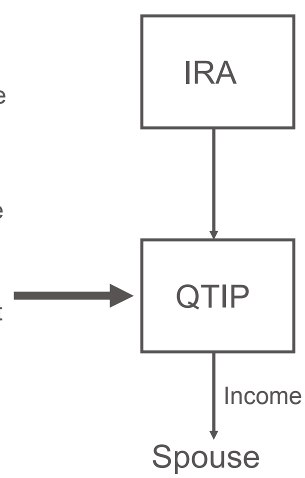
Rev. Rul. 2006-26 – Tradition Definition of TAI

- Determine income for trust (exclusive of IRA)
  - Annually distribute that to spouse
- Determine income for IRA (exclusive of trust)
  - If spouse exercises his/her withdrawal power, distribute that amount to the spouse

QTIPing An IRA – Rev. Rul. 2006-26

4 step process:

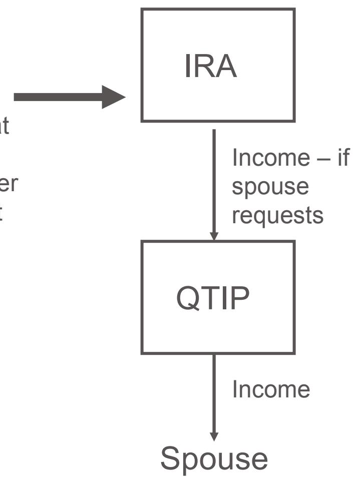
1. Trust instrument states that spouse can require the trust and IRA to invest in productive assets and spouse has the right to compel the trustee to withdraw the IRA income each year and pay it to the spouse
2. Determine total return of trust (exclusive of IRA) and allocate that amount between income and principal. Annually distribute the amount allocated to income to spouse



QTIPing An IRA – Rev. Rul. 2006-26

4 step process:

3. Determine total return of <u>IRA</u> (exclusive of trust) and allocate that amount between income and principal. If spouse exercises his/her withdrawal power, the trustee must pay the income to the spouse
4. Make QTIP election for BOTH the IRA and the QTIP trust



2008 Revisions

- 2008 revisions effective for tax years beginning after May 30, 2006 i.e. calendar years ending on December 31, 2007 or later
- Negates UPIA §409
- Revisions affects trusts qualifying for the marital deduction (§2056(b)(5) LE/GPOA, QTIPs, QDOTs) that are the beneficiary of:
  - IRA
  - 401(k)
  - Annuity
  - Deferred compensation

2008 Revisions – UPIA Reaction to Rev. Rul. 2006-26

- UPIA now provides two sets of rules:
  - One for trusts qualifying for the marital deduction
  - One for non-marital trusts
- Introduces the term “separate fund”

2008 Revisions – UPIA Reaction to Rev. Rul. 2006-26

- UPIA §409(a)(2) defines the term “separate fund”
  - Includes a private or commercial annuity, an IRA and a pension, profit-sharing, stock-bonus or stock ownership plan

2008 Revisions – UPIA Reaction to Rev. Rul. 2006-26

- How to account for separate funds
  - Trustee determines the "internal" income of each separate fund (IRA) for the accounting period. 1997 UPIA §409(f) (2008 revision)
    - Treats the separate fund as if it were a separate trust for TAI purposes
  - If surviving spouse requests, the trustee can demand that all the internal income from the separate fund be distributed to the trust
    - Internal income of the IRA is determined and if the spouse requests the income the trustee can demand that the internal income of the IRA be distributed to the marital trust
    - Trustee must, upon request of the surviving spouse, transfer from principal to income to the extent the distribution from the separate fund is less than the internal income of the fund

2008 Revisions – UPIA Reaction to Rev. Rul. 2006-26

- What if internal income can't be calculated?
- UPIA 2008 revisions offer alternative method of accounting. 1997 UPIA §409(g) (2008 revision)
- Example of situations where the internal income can't be computed:
  - IRA invested in mutual funds
  - Annuity contracts
  - Lack of information

2008 Revisions – UPIA Reaction to Rev. Rul. 2006-26

- Alternative method of accounting if internal income cannot be calculated
- Where internal income of separate fund can't be calculated but you know the value of the separate fund
  - Internal income is equal to at least 3% but no more than 5% of the value of the separate fund
    - Each individual state will set the percentage for their state
  - Use the most recent statement of value of the fund before the beginning of the accounting period

2008 Revisions – UPIA Reaction to Rev. Rul. 2006-26

- If you can't calculate the internal income of the separate fund or the value of the fund
  - Internal income is deemed to be the interest rate (between 3-5%, depending on the particular state) times the present value of the expected future payments using the §7520 rate for the month preceding the accounting period for which the computation is made
  - Example: Trust receives payments of $5,000/month for 20 years beginning October, 2010.
    - October, 2010 §7520 rate = 2.0%
    - PV of right to receive $60,000 per year for 20 years = $981,086
    - Range for income
      - 3% = $29,433 x 3/12 = $7,358
      - 5% = $49,054 x 3/12 = $12,264

	Income	Principal	T I	DNI
INCOME				
Interest	2,500		2,500	2,500
Dividends	5,000		5,000	5,000
P/ship Income	20,000		50,000	50,000
IRA	2,000	18,000	20,000	20,000
Rental Income	40,000		40,000	40,000
Corp. Liq.				
EXPENSES				
Rental Exp.	(14,000)		(14,000)	(14,000)
Depreciation		(6,000)		
Trustee's Fees				
Total				

	Income	Principal	T I	DNI
INCOME				
Interest	2,500		2,500	2,500
Dividends	5,000		5,000	5,000
P/ship Income	20,000		50,000	50,000
IRA	2,000	18,000	20,000	20,000
Rental Income	40,000		40,000	40,000
Corp. Liq.		100,000	100,000	
EXPENSES				
Rental Exp.	(14,000)		(14,000)	(14,000)
Depreciation		(6,000)		
Trustee's Fees				
Total				

	Income	Principal	T I	DNI
INCOME				
Interest	2,500		2,500	2,500
Dividends	5,000		5,000	5,000
P/ship Income	20,000		50,000	50,000
IRA	2,000	18,000	20,000	20,000
Rental Income	40,000		40,000	40,000
Corp. Liq.		100,000	100,000	
EXPENSES				
Rental Exp.	(14,000)		(14,000)	(14,000)
Depreciation		(6,000)		
Trustee's Fees	(5,000)	(5,000)	(10,000)	(10,000)
Total	50,500	107,000	193,500	93,500

	Income	Principal	T I	DNI
INCOME				
Interest	2,500		2,500	2,500
Dividends	5,000		5,000	5,000
P/ship Income	20,000		50,000	50,000
IRA	2,000	18,000	20,000	20,000
Rental Income	40,000		40,000	40,000
Corp. Liq.		100,000	100,000	
EXPENSES				
Rental Exp.	(14,000)		(14,000)	(14,000)
Depreciation		(6,000)		
Trustee's Fees	(5,000)	(5,000)	(10,000)	(10,000)
Total	50,500	107,000	193,500	93,500

2008 Revisions – Income Taxes

- UPIA §505
- Deals with allocation of income taxes payable on income received from a pass-through entity

- ## 2008 Revisions – Income Taxes

- General Rule Under 1997 UPIA §505:
  - Tax on receipts allocated to income must be paid from income
    - Example: Tax on receipt of interest and dividends paid from income
  - Tax on receipts allocation to principal must be paid from principal
    - Example: Tax on receipt of capital gain paid from principal
  - Tax on trust’s share of an entity’s (p/ship, S corporation) taxable income is allocated proportionately to extent receipts from entity are income or principal

2008 Revisions – Income Taxes

- UPIA 2008 revision §505
  - A tax required to be paid by the trustee on a trust's share of taxable income received from an entity must be paid:
    - From income to the extent that the receipts from the entity are allocated only to income
    - From principal to the extent that the receipts from the entity are allocated only to principal
    - Proportionately from income and principal to the extent payments are allocated to both
    - From principal to the extent that the tax paid by the trust on the income from the entity exceeds the cash distributed from the entity
    - Must take into account any deduction received for amounts paid to the income beneficiary for which a distribution deduction is allowed

2008 Revisions – Income Taxes

- Example:
  - Trust owns an interest in a p/ship and receives a Schedule K-1 reporting $50,000 of rental income and receives a distribution of only $10,000
  - Trust is in 35% tax bracket
  - Tax on $50,000 of rental income is $17,500 which exceeds the $10,000 cash received from the p/ship
  - The $10,000 of cash received plus $7,500 is used to pay the tax
  - $10,000 of the tax paid is allocated to income and $7,500 of the tax paid is allocated to principal

2008 Revisions – Income Taxes

- Example – same as in previous example except cash received is $20,000 (cash received exceeds tax on trust's share of entity's income):
  - Trust owns an interest in a p/ship and receives a Schedule K-1 reporting $50,000 of rental income and receives a distribution of $20,000
  - Trust is in 35% tax bracket
  - Tax on $50,000 of rental income is $17,500 which is less than the $20,000 cash received from the p/ship
  - $17,500 of cash received is used to pay the tax
  - Entire $17,500 of the tax paid is allocated to income

2008 Revisions – Income Taxes

- Algebraic equation needed to determine the amount of the distribution.
- The formula is as follows:
- Distribution to the income beneficiary is equal to the cash paid by the entity to the trust less the rate of tax times the Form K-1 income reported to the beneficiary divided by one less the tax rate on the income
- Stated algebraically:

$$D = \frac{C-(R \times K)}{1-R}$$

D is the distribution to the income beneficiary

C is the cash paid by the entity to the trust

R is the rate of tax on the income

K is the income reported to the beneficiary on the entity's Form K-1

2008 Revisions – Income Taxes

D = (20,000 - .35 x 50,000)/1 - .35
D = (20,000 – 17,500)/.65
D = 2,500/.65
D = 3,846

Proof:

Tax per K-1	50,000
Payment to beneficiary	(3,846)
Trust taxable income	46,154
Trust tax rate	x .35
Fiduciary income tax	16,154

Partnership distribution	20,000
Fiduciary income tax	(16,154)
Payment to beneficiary	3,846

Distributions from Trusts and Estates

- Unless governing instrument states otherwise:
  - An income distribution from an estate or trust will be treated as income
  - A principal distribution from an estate or trust will be allocated to principal
  - Governed by 1997 UPIA §402

Other 1997 UPIA Provisions

- Allocation of receipts from financial instruments e.g. derivatives, options, asset backed securities. 1997 UPIA §§414 and 415
- Distributions made because of environmental laws. 1997 UPIA §502(a)(7)

Summary

- TAI
  - TAI is determined by the terms of the governing instrument
  - If governing instrument is silent, look to state law
    - State law most likely a version of the UPIA
- TAI is amount required to be distributed to beneficiary of a simple trust or a tier one beneficiary of a complex trust

Thank You!!!