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Estimated Taxes for Trusts and Estates

Allan G. Donn

ESTIMATED TAXES FOR TRUSTS AND ESTATES

BY

ALLAN G. DONN*

I. GENERAL RULE.

For taxable years beginning after December 31, 1986, all trusts and any estates with respect to any taxable year ending two or more years after the date of the decedent's death, will be required to make estimated tax payments in the same manner as individuals. § 6654(l). A similar requirement has been imposed by Virginia for taxable years beginning on or after January 1, 1988. Va. Code § 58.1-490.

In addition, the Act repealed § 6152, which permitted estates to pay income tax in four equal installments beginning with the due date of the return and quarterly thereafter. Act § 1404(c)(1).

Interim guidance has been provided by questions and answers in Notice 87-32, 1987-17 I.R.B. 15 and instructions to Form 1041-ES.

II. COMPUTATION OF TAX.

The required annual payment for a trust or estate will be the lowest of the amounts computed under the Prior Year Alternative, the Current Year Alternative and the Annual Income Alternative.

A. Twelve Month Years.

1. General Rule.

a. Current Year Alternative.

90% of the tax shown on the return for the

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*Thanks to Mark R. Haskell for the preparation of this outline.

for such year.[1]

b. Prior Year Alternative.

100% of the tax shown on the return for the preceding taxable year (if a return was filed for a preceding 12 month taxable year).

c. Annualized Income Alternative.

(i) In General.

The excess, if any, of the applicable percentage of the tax for the taxable year computed by placing on an annualized basis the trust's or estate's taxable income and alternative minimum taxable income for the months in the taxable year ending before the due date of the installment, over the aggregate amount of any prior required installments for the taxable year.

The applicable percentages for this purpose are 22.5% for installment 1, 45% for installment 2, 67.5% for installment 3, and 90% for installment 4.

Annualized taxable income for purposes of this alternative is calculated by multiplying the taxable income of the trust or estate (without giving effect to the Section 642(b) deduction) for the calendar months

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[1]Included in the Committee on Ways and Means budget reconciliation recommendations to the House Budget Committee is a proposal to delay until 1988 the 1986 Act provision increasing the amount from 80% to 90%. Ways and Means Press Release #23-A, Daily Tax Highlights & Documents 620, 621 (10/19/87).

preceding the month in which the installment is due by a fraction, the numerator of which is the number of months in the taxable year and the denominator of which is the number of months preceding the month in which the installment is due, and then subtracting the Section 642(b) deduction. <u>See</u> Notice 87-32, <u>supra</u> answer 9.

(ii) Adjustments.

In computing the required installment under the annualized income alternative, the trustee may take into account the distribution deduction of Section 651(a) regardless of whether actual distributions are made during the period. The deductions will be limited to distributable net income ("DNI") for the months preceding the month in which the installment is due.

Similarly, the Section 661 deduction may also be taken into account but may not exceed DNI for the period.

In the case of a trust or estate required to distribute specific amounts during the year, the Section 661(a)(1) adjustment for estimated tax purposes will equal the greater of the amount of actual distributions in the months preceding the month in which the installment is due or the specific amount subject to current distribution times the number of months in the calendar year preceding the month in which the installment is due divided by twelve.

If the trust must distribute a fixed percentage of its income annually, the amount of the distribution deduction for months preceding the month in which the installment is due will equal the trust accounting income during the period times the percentage subject to current distribution.

If the trustee or executor is empowered to make discretionary distributions, only actual distributions made during the months of the taxable year preceding the month in which the installment is due may be taken into account. However, the trustee or executor may also take into account distributions made within the 65 day period following the end of the taxable year in calculating the installment due on the 15th day of the first month of the succeeding taxable year (to the extent of DNI during the applicable period). *See* Notice 87-32, *supra* answer 8.

B. Short Years.

1. Prior Year Alternative.

a. General Rule.

Multiply the tax shown on the prior year return by a fraction, the numerator of which is the number of months in the short year and the denominator of which is 12. Generally, the prior year alternative may not be used if the prior year is a year of less than 12 months. _See_ Notice 87-32, _supra_ answer 4.

b. Special Rule for Short Year in 1987.

A trust or estate which has a short 1987 taxable year may use the prior year method for 1988 only. Divide the 1987 tax by the number of months in the short year and multiply the result by 12. _Id_. answer 5.

2. Required Percentage Payments Under the Prior Year or Current Year Alternatives for Short Taxable Years.

The percentage due will vary depending on the number of installments. If one installment is due, 100% of the estimated tax liability must be paid; if 2 installments are due, 50% must be paid; if 3 installments are due, 33-1/3% must be paid with each installment, and if 4 installments are due, 25% of the estimated tax liability must be paid with each installment. _Id_. answer 6.

3. Applicable Percentage Under Annualized Year Alternative for Short Taxable Years.

If three installments are due, 30% must be paid with the first installment, 60% with the second and 90% with the third. If two installments are due, 45% must be paid with the first and 90% with the second. If one installment is due, 90% of the liability must be paid. Id. answer 7.

4. Section 642(b) Deduction Adjustment for Trusts and Estates with Short Taxable Years Due to Change in Annual Accounting.

Reduce the Section 642(b) deduction by a fraction the numerator of which is the number of months in the short taxable year and the denominator of which is 12. Id. answer 10.

III. COMMON TRUST FUND PARTICIPANTS.

"In determining the taxable income of a trust that is a common trust fund participant for the months in the taxable year of the participating trust preceding the month in which any installment of estimated tax is due, a participating trust shall take into account the trust's share of items from the [common trust fund] described in Section 584(c) (whether distributed or not) for the [common trust fund's] taxable year ending with or within the participating trust's taxable year, to the extent such income is attributable to months in such [common trust fund's] taxable year that preceded the month in the participating trust's taxable year in which the installment is due." Id. answer 11.

IV. PAYMENTS TREATED AS PAID BY BENEFICIARY.

New Section 643(g) permits a trustee (but not an executor) to elect to assign any amount of its estimated tax payments in excess of the tax shown on the trust's return to one or more beneficiaries. The election must be made on the income tax return of the trust filed within 65 days of the end of the trust's taxable year.[2]

The amount of the credits so assigned will be treated as a distribution received by the beneficiary on the last day of the trust's taxable year. However, such amounts will be treated as a payment of estimated tax by the beneficiary on January 15 following the taxable year.

A trust making a valid Section 643(g) election will be eligible for the Section 661 deduction. Notice 87-32, supra answer 12.

V. EXCEPTIONS TO UNDERPAYMENT PENALTY.

A. No penalty is imposed if the tax shown on the return (or the actual tax if no return is filed) reduced by the credit for taxes withheld is less than $500. § 6654(e)(1).

B. No penalty is imposed on a trust or estate which had no tax liability for its preceding taxable year if it was a 12 month year. Id. -(e)(2).

C. § 6654(e)(3) authorizes the Secretary to waive the penalty if "by reason of casualty, disaster, or other unusual

[2]This is a trap because the date is earlier than the return would otherwise be due. For 1988, the date is March 7.

circumstances the imposition of such addition to tax would be against equity and good conscience." _See also id._ answer 2.

D. IRS will waive the penalty for trusts or estates using either the current year alternative or the annualized income alternative to compute installments due before July 1, 1987, if the fiduciary makes a good faith effort accurately to determine the amount of the required installment and makes a timely payment of the amount so determined. _Id._ answer 2.

E. Trusts and estates are not required to take into account alternative minimum taxable income for estimated tax purposes until guidance is provided under Section 59(c).