

FIDUCIARY INCOME TAX BASICS

Please note this is a summary of basic information on fiduciary income tax returns for estates and trusts in the state of Indiana. We anticipate that members will look to the tax form instructions and the Internal Revenue Code ("IRC") for more detailed information.

- Fiduciary income tax returns (IRS Form 1041 and IDR Form IT-41) are required to be filed by any Indiana estate or trust with \$600 or more in gross income during the tax year.
- File IRS Form 56 to notify the IRS of the authority of the Executor, surviving spouse, Trustee or other party to sign the Form 1041 for a decedent's estate.
- An estate's first fiscal year begins the day after the decedent's death and can end on any month-end through the month-end before the one-year anniversary of the date of death. A shorter tax year may be chosen if it provides tax advantages, such as the timing of distributions. Fiduciary income tax returns filed on a fiscal year basis are due to be filed by the 15th day of the 4th month after the end of the fiscal year (6/30 fiscal year end would be due 10/15).
- If the decedent's revocable trust used the decedent's Social Security Number prior to death, you must obtain a new EIN for the trust as a new taxpayer.
- Trusts use a calendar tax year, unless the Trustee of a decedent's revocable trust files an IRC Sec. 645 Election (file Form 8855 with the Form 1041) to treat such revocable trust as an estate, allowing the estate and trust to file a combined set of fiduciary income tax returns using the estate's fiscal year. Note that there is a limit on the length of time that a trust may file on a fiscal year basis under the Sec. 645 Election. After such limited time, the trust is required to convert to a calendar tax year. Please refer to the Form 1041 instructions and the IRC for more detailed information.
- If you have a small estate with no Executor appointed, the Trustee of the decedent's revocable trust may file the Sec. 645 Election to be treated as an estate for fiduciary income tax purposes. If such an election is made, the Trustee will use the estate's fiscal year beginning date and may choose the end of its first fiscal year.
- Estates and trusts must report income received from all sources, including capital gains or losses. This includes income in respect of a decedent ("IRD") due to the decedent not paid until after death (including retirement assets paid to the estate).
- Deductions that have been taken on a federal estate tax return (Form 706) may not also be taken as income tax deductions on Form 1041. Some accrued deductions may be deducted on both, so check the tax form instructions and the IRC for more information. Estates and trusts may deduct many of the same items as individuals, such as state and local taxes, including income tax, real estate tax and personal property tax (currently limited to \$10,000), fiduciary fees, attorney, accountant and return preparer fees, and administration expenses that would not have been incurred if the property were not held in an estate or trust. No deductions for medical expenses (deduct on decedent's final Form 1040) or funeral expenses (deduct on Form 706).

- Fiduciary income tax deductions must be allocated between taxable and non-taxable income, resulting in only those deductions allocated to taxable income being deductible.
- An income distribution deduction is allowed for any distributions made to heirs/beneficiaries during tax fiscal year of the estate or trust, and the "distributable net income" is calculated pursuant to IRC Sec. 651. Capital gains are taxed at the estate or trust level and not included in distributions, unless the decedent's documents provide the fiduciary with discretion to treat capital gains as income. The exception to this is in the final year of the trust or estate, in which all income, including capital gains and losses, and "excess deductions on termination" are passed out to the distributees on a Schedule K-1 in their proportionate share of the distributions made.
- An estate tax deduction is allowed if federal estate tax was paid with Form 706 and the IRD included on the Form 706 is also included on the Form 1041. In that tax year, the estate may deduct the portion of the federal estate tax paid that is attributable to the inclusion of the IRD on Form 706.
- An estate or trust may take a charitable deduction for a donation to a charity only if the decedent's documents direct such distribution to the charity, or if a written pledge to such charity was made by the decedent during lifetime (and you have documentation of such pledge). Any other distributions to charity may not be deducted by the estate or trust for income tax purposes. If any other charitable donations are desired by beneficiaries, distributions may be made to allow them to make the donations themselves and take the charitable deductions on the beneficiaries' personal income tax returns.
- If the estate can be closed within one year of the date of death, you may file a set of first/final fiduciary income tax returns before closing the estate with the Court. If income is earned after the end of the first fiscal year, the estate will be required to file a second year (or more) of fiduciary income tax returns.
- If you are at the end of the final fiscal year, income has been stopped, and you have not yet completed the final distributions, IRC Sec. 663(b) allows final distributions made within 65 days of the end of the fiscal year to be treated as if they were completed prior to the end of the fiscal year.
- In any year in which distributions are made, the Form 1041 will include a Schedule K-1 for each beneficiary reporting his or her share of the income to be reported on the respective beneficiary's income tax return. Such income is income to the beneficiary in the year of the end of the fiscal year (a 2023-2024 fiscal year will pass out 2024 income to the beneficiaries, regardless of when the distributions were made). The Schedules K-1 must be filed with the tax forms and also be provided to each respective beneficiary.