

Estate and Gift Tax Returns

2011 Tax Year | Small Business Quickfinder® Handbook
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Use to allocate income and expenses to:

- Form 1040 (Decedent's Income Tax Return)
- Form 1041 (Fiduciary's Income Tax Return)
- Form 706 (Estate Tax Return)

Income and Expense Chart for a Decedent		
—Cash Method of Accounting—		
Category	Where to Report	Explanation
Administration Expenses	Form 706, Schedule J or Form 1041	Court costs; fees paid to attorneys, accountants, personal representatives, appraisers and tax preparers. Amounts paid or reasonably expected to be paid during estate administration are deductible on Form 706; or, executor can elect to claim some administration expenses on Form 1041 when paid. On Form 1041, expense is subject to 2% adjusted gross income (AGI) limit unless it would not have been incurred if the property had not been held in the estate. If deducted on Form 1041, a waiver should be attached. See discussion under <i>Itemized Deductions on Page H-6</i> .
Business Income and Expenses	Final Form 1040, Schedule C and Schedule F	Income and expenses received or paid up until date of death. <ul style="list-style-type: none"> • Business income is subject to self-employment (SE) tax on the final Form 1040. • A net operating loss (NOL) cannot be carried from the decedent's final Form 1040 to Form 1041.
	Form 706 and Form 1041 (or beneficiary's return)	Income and deductions accrued at date of death but not actually received or paid until after death are reported on Form 706 and Form 1041 [as income and deductions in respect of a decedent (IRD and DRD)].
	Form 1041 (Use Schedule C or Schedule F of Form 1040)	If estate continues to operate the business, income and expenses incurred after death. Net income is not subject to SE tax. NOLs incurred by estate are computed same way as for individuals. Any unused NOL on final estate income tax return can be passed through to beneficiaries on Schedule K-1 (Form 1041). NOLs are not allowed by estates engaged only in investment activities.
Business Tax Credits	Final Form 1040, Form 3800	Credits and carryforward credits must be used on final Form 1040. Unused amounts cannot be carried to Form 1041. [IRC §196(b)]
Capital Gains and Losses	Final Form 1040, Schedule D	When payment is received through date of death. Capital loss carryovers are deductible up to the annual limitation on final Form 1040. Generally, excess capital losses are lost. (For deaths in 2010, if the executor elected out of the estate tax rules and instead applied the modified carryover basis rules, basis can be increased by the sum of the capital loss carryovers). See discussion under <i>Modified Carryover Basis for Inherited Property for Deaths in 2010 (IRC §1022) on Page H-18</i> . Unused capital loss carryover from separately owned property is not available to a surviving spouse. (Letter Rul. 8510053)
	Form 706 and Form 1041 (or beneficiary's return)	Capital asset transactions before death when payment is received after death (IRD) (for example, installment sales).
	Form 1041, Schedule D (or beneficiary's return)	Sales/exchanges occurring after death; generally, basis of property is date-of-death FMV, value at alternate valuation date or special-use value if elected on Form 706. Gains/losses are automatically long-term, subject to same capital gains rates as individuals (maximum 15%). Net capital loss allowed each year is limited to \$3,000. Unused capital loss can be passed through to beneficiaries on Schedule K-1 (Form 1041) when estate terminates. For deaths in 2010 where the executor elected out of the estate tax rules, basis of property received is the lesser of: (1) the decedent's adjusted basis (with certain modifications) or (2) the FMV of the property at the date of death. The decedent's holding period is tacked on to the recipient's. See <i>Holding period rules on Page H-18</i> for special rules applicable in 2010.

Income and Expense Chart for a Decedent (Continued)

—Cash Method of Accounting—

Category	Where to Report	Explanation
Casualty and Theft Losses	Final Form 1040	Casualties and thefts incurred before death.
	Form 706, Schedule L or Form 1041	Casualties and thefts during administration of estate are reported on Form 706 or, if elected, on Form 1041. If reported on Form 1041, attach a statement that loss was not claimed on Form 706.
Charitable Contributions	Final Form 1040	Amounts contributed before death. (IRC §170)
	Form 1041, Schedule A	Contributions are deductible only if decedent's will requires that contribution be made from gross taxable income [Reg. §1.642(c)-1]. AGI limitations applicable to individuals do not apply to estates.
	Form 706, Schedule O	Value of property in decedent's estate that was transferred by decedent (via his will) or by qualified disclaimer to a charity described in Section 2055(a).
Claims Against Estate	Form 706, Schedule K	Enforceable personal obligations of decedent at time of death plus interest accrued up to time of death.
Credit for the Elderly or the Disabled	Final Form 1040, Schedule R	Figured as though decedent lived full year.
Deductions in Respect of a Decedent (DRD)	Form 706 and Form 1041 (or beneficiary's return)	Business expenses, income-producing expenses, interest and taxes for which decedent was liable but which are not deductible on final Form 1040.
Depreciation	Final Form 1040	Depreciation for period ending on date of death. Short tax year rules apply; see Tab J .
	Form 1041, Form 4562	If estate continues to operate decedent's business or rental property, depreciation is allocated between estate and income beneficiaries (assuming estate is claiming an income distribution deduction) on basis of income allocated to each. Estate is not allowed Section 179 deduction. Short tax year rules apply for any tax year of the estate less than 12 months. See Tab J for short tax year rules.
Dividend Income	Final Form 1040, Schedule B	Dividends received through date of death.
	Form 1041, Schedule B (or beneficiary's return)	Dividends received after date of death. Estates and trusts are subject to same reduced tax rate on qualified dividends as individuals (15% maximum rate).
	Form 706, Schedule B and Form 1041 (or beneficiary's return)	Dividends declared to shareholders of record before death, but not available or received until after death (IRD).
Earned Income Credit (EIC)	Final Form 1040, Schedule EIC	Available even if decedent's return covers only a part year and decedent would not have qualified with a full year's income. A decedent's credit is refundable.
Estate Tax Deduction	Form 1041 (or beneficiary's Form 1040, Schedule A)	If federal estate tax was paid on IRD, a deduction can be claimed on the income tax return that reports the IRD.
Exemptions	Final Form 1040	Full amount allowed for decedent; no proration required. For decedent to claim exemption of a dependent, decedent must have furnished over one-half of support for entire year.
	Form 1041	An estate is allowed a \$600 exemption even if first return period is less than 12 months.
Funeral Expenses	Form 706, Schedule J	Allowed on Form 706, never on Form 1041 or 1040. State law generally determines which items are deductible <i>funeral expenses</i> . Reg. §20.2053-2 classifies the following as funeral expenses if allowable under local law: tombstone, monument, mausoleum, burial lot for decedent or family (including costs for future care) and transportation of the person bringing body to burial place.
Income and Expenses Generally	Final Form 1040	Income received and expenses paid before death.
	Form 1041 (or beneficiary's return)	Income received and expenses paid after death, including income and expenses in respect of a decedent.
	Form 706	Income and expenses in respect of decedent (also reported on Form 1041 or beneficiary's return).
Income in Respect of a Decedent (IRD)	Form 706 and Form 1041 (or beneficiary's return)	All gross income that the decedent had the right to receive and is not includable on final Form 1040. If estate tax is paid on this income, a deduction for estate tax paid can be claimed on the income tax return that reports income.
Income Tax Due on Final Form 1040	Form 706, Schedule K	Federal and state income taxes unpaid at date of death, including tax due on final Form 1040 prepared and filed after death.
Installment Sales Contracts Held by Decedent	Final Form 1040, Form 6252	Payments received through date of death.
	Form 706 and Form 1041 (or beneficiary's return)	If note cancels at death under decedent's will, date-of-death value is reported on Form 706 and unrecognized gain on Form 1041 (as IRD). If decedent and obligor are related, FMV of installment note cannot be less than its face value.
	Form 1041 (or beneficiary's return)	If note is self-canceling at death (a so-called self-canceling installment note or SCIN), unrecognized gain is included on Form 1041 (as IRD).
	Form 706 and Form 1041 (or beneficiary's return) (attach Form 6252)	If contract is not canceled at death, difference between face amount of obligation and decedent's basis is reported on Form 706 and is considered IRD [IRC §691(a)(4)]. As payments are collected, recipient reports income using decedent's gross profit percentage.
Interest Earned	Final Form 1040, Schedule B	Interest received through date of death plus original issue discount (OID) earned through date of death.
	Form 706, Schedule B and Form 1041 (or beneficiary's return)	Interest accrued but unpaid at date of death is IRD.
	Form 1041 (or beneficiary's return)	Interest earned and received after date of death.
Interest Expense	Final Form 1040	Deductible interest paid before death.
	Form 706 and Form 1041 (or beneficiary's return)	Deductible interest expense accrued before death but paid after death (DRD). Nondeductible personal interest accrued before death but paid after death is allowed as a debt of estate on Form 706, Schedule K.
	Form 1041 (or beneficiary's return)	Interest paid after death. Use Form 4952 for investment interest expense. Interest expense on decedent's personal residence is qualified residential interest only if a beneficiary uses it as a residence during estate administration [IRC §163(h)(4)]. Otherwise, the interest is either investment interest (subject to limitations on Form 4952), rental interest expense or nondeductible personal interest. Investment interest expense attributable to tax-exempt income is not deductible.

Table continued on the next page

Income and Expense Chart for a Decedent (Continued)

—Cash Method of Accounting—

Category	Where to Report	Explanation
IRA, SEP, SIMPLE, Keogh, 401(k), etc.	Form 706, Schedule I	The account balance of all tax-deferred benefits at the time of death. Benefits are taxable to the beneficiary when distributed (IRD). Beneficiaries can roll over IRA funds.
	Final Form 1040	Amounts actually received before death.
	Form 1041 (or beneficiary's return)	Distributions made after death (IRD). These distributions are not subject to the 10% early withdrawal penalty. [IRC §72(t)(2)(A)(ii)]
Medical Expenses	Final Form 1040, Schedule A	Medical expenses paid before death. Can elect to deduct medical expenses incurred before death but paid from the estate within one year of the day following death [Reg. §1.213-1(d)]. Election does not apply to medical expenses for dependents of the decedent. To elect, attach a statement to Form 1040 stating the estate has waived the right to claim medical expense for estate tax. With the election, deduction is taken on Form 1040, Schedule A in year costs were incurred (a Form 1040X may be needed).
	Form 706, Schedule K	Unpaid medical expenses at death are reported on Form 706 as a claim against the estate, unless an election is made to report on decedent's final Form 1040. Amounts deducted on Form 706 are not subject to the 7.5% AGI limitation. If deduction taken on Form 1040, amount not allowed due to 7.5% AGI limitation cannot be claimed on Form 706.
	Form 1041	Any insurance reimbursements after death of amounts previously deducted on Form 1040. Report as IRD.
Miscellaneous Itemized Deductions	Final Form 1040	Miscellaneous itemized deductions paid before death.
	Form 706, Schedule J or Form 1041	Unpaid miscellaneous itemized deductions at date of death are reported on Form 706. When paid, deduct on Form 1041 as DRD.
	Form 1041	Incurred and paid after death: may be subject to 2% AGI limit. See <i>Deductions on Page G-5</i> .
Partnership Income (Loss)	Final Form 1040, Schedule E	Income (or loss) up to date of death using any reasonable method of allocating income (loss). Allocation is often based on pro rata amount for year or interim closing of books.
	Form 1041 (or beneficiary's return)	Income (or loss) after death not included on final Form 1040.
Passive Losses	Final Form 1040	Losses are allowed to extent of passive income, plus accumulated unused losses to extent they exceed any increase in basis allocated to the activity. For example, if a passive activity's basis is increased \$6,000 upon taxpayer's death, and unused passive activity losses as of date of death are \$8,000, decedent's deduction is \$2,000 (\$8,000 – \$6,000). Note there are special rules for decedents who died in 2010 and the executor elected the modified carryover basis rules instead of the estate tax rules.
	Form 1041	Estates are subject to the same passive loss limitation rules as individuals. The fiduciary's level of participation determines the classification. If decedent actively participated in a rental real estate activity before death, the estate will be allowed the special \$25,000 rental real estate exemption for up to two years after decedent's death.
Personal Residence	Form 1041	The Section 121 exclusion of gain from sale of personal residence does not apply to estates. If personal residence is a capital asset to the estate (either held for investment or rental purposes), estate can deduct loss on sale. If property is used by estate beneficiaries for personal purposes, loss on sale is not deductible. If home was not subject to probate and passed directly to heirs, sale of home is reported on beneficiaries' Form 1040. For deaths in 2010 where the modified carryover basis is elected, allocation of basis increase to other assets may be preferable since gain may be excluded by the beneficiary.
Real Estate, State and Local Income Taxes	Final Form 1040, Schedule A	Paid before death. General sales taxes deductible if state and local income taxes not deducted. [IRC §164(b)(5)]
	Form 706, Schedule K and Form 1041 (or beneficiary's return)	Real estate taxes accrued before death but paid after death.
	Form 1041 (or beneficiary's return)	Accrued and paid after death.
Rental Income and Expenses	Final Form 1040, Schedule E	Income and expenses received or paid before death.
	Form 706 and Form 1041 (or beneficiary's return)	Income and expenses accrued before death but not actually received or paid until after death (IRD and DRD). Passive activity loss rules apply to estates (for Form 1041 reporting).
	Form 1041 (use Schedule E of Form 1040)	Income and expenses accrued and received or paid after death. Passive loss rules apply to estates.
S Corporation Income (Loss)	Final Form 1040, Schedule E	Pro rata share of income (or loss) up to death. Generally, amount of income (or loss) is computed as follows: S corporation income or loss for the year, divided by number of days in S corporation's year, multiplied by number of days shareholder was alive. Can elect under Section 1377(a)(2) to close S corporation books on day of death.
	Form 1041 (or beneficiary's return)	Income (or loss) after date of death and not included on final Form 1040.
Series E or EE U.S. Savings Bond Interest (Decedent did not elect to report interest annually)	Final Form 1040 or Form 1041	Two options: (Rev. Rul. 68-145) 1) Executor elects to report interest accrued before death on final Form 1040. Interest accrued after death is reported on Form 1041 (or beneficiary's return) in year bond is redeemed or matures. 2) All interest (both before and after death) is reported on Form 1041 (or beneficiary's return) in year bond is redeemed, matures or an election is made to report income. Interest accrued before death is IRD. Alternatively, recipient of an inherited bond can elect to report interest annually. (Rev. Rul. 64-104)
	Form 706, Schedule B	FMV of bonds, including interest accrued up to date of death, which may be IRD.
Series E or EE U.S. Savings Bond Interest (Decedent elected to report interest annually)	Final Form 1040	Interest accrued up to date of death.
	Form 1041 (or beneficiary's return)	Interest accrued after death. Note that the last Series E bonds matured in 2010 and are no longer accruing interest.
	Form 706, Schedule B	FMV of bonds as of date of death. No IRD.
Social Security	Final Form 1040	Payments cease at death; therefore, subject to reporting on final Form 1040.
Standard Deduction	Final Form 1040	Full amount allowed. No proration required.
Wages	Final Form 1040	Wages received before death.
	Form 706, Schedule F and Form 1041 (or beneficiary's return)	Wages earned before death but received after death (IRD).