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Trusts & Estates Law: Speakers review fiduciary income taxes, lay out the basics

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By Alessandra Scalise

A review of grantor retained annuity trusts [GRAT] and fiduciary income taxes was presented as part of the annual meeting of the Trusts and Estates Law Section on January 25. The section is chaired by Michael E. O'Connor of Syracuse (Delaney & O'Connor LLP), and the program chair was Elizabeth A. Hartnett of Syracuse (Mackenzie Hughes LLP).

Basics I

Sharon L. Wick of Buffalo (Phillips Lytle LLP) covered the topic of GRATs. A GRAT "is a planning vehicle" used to transfer assets. A GRAT occurs when an individual/grantor transfers assets (e.g., property) into an irrevocable trust for the benefit of one or more beneficiaries, but the grantor still retains an annuity interest for a certain term, that is "fixed and ascertainable."

The "best practice for a minimum term should be two years" noted Wick. The annuity amount should be either a percentage or a specific sum of the initial value of the trust and should be paid out at least annually to the grantor based on the anniversary date of the trust or the taxable year of the trust. At the end of the fixed term, the remaining assets (income and appreciation) are distributed to the beneficiaries with little, if any, gift tax. If the grantor dies prior to the end of the fixed term, then the assets will remain in the estate.

A variation of the GRAT is called a single asset GRAT. This occurs when a grantor wishes to protect more than one asset and each asset is placed in a separate GRAT. This is generally done to "protect the growth of a performing asset from being offset by the losses of a non-performing asset," noted Wick. Another variation of the GRAT is called "a zeroed-out GRAT," which occurs when the "grantor's annuity interest is equal to the value of the property transferred to the trust causing the value of the remainder interest to be zero," continued Wick.

Basics II

Prof. Terry L. Turnipseed of Syracuse (Syracuse University College of Law) reviewed the topic of income taxation of trusts and estates (fiduciary taxes). Turnipseed stated the five basic concepts that are involved: (1) "mostly, the taxation of trusts and estates follows the rules for individual taxpayers; (2) the estate-planning documents are the primary authority; (3) taxes are paid at the final destination by the recipient beneficiaries absent an accumulation of income; (4) except for the year of termination, no losses pass out to the beneficiaries; and (5) the satisfaction of a pecuniary bequest with appreciated property or IRD is treated as a sale or exchange."

A "trust or estate is a separate legal entity for federal tax purposes and the fiduciary tax return," continued Turnipseed. The form utilized to "report the income, deductions, gains, losses, etc. of a domestic decedent's estate, trust or bankruptcy estate is Form 1041." A fiduciary "must file a tax return on Form 1041 if a domestic estate has gross income of $600 or more during a tax year," noted Turnipseed. A "trust income tax return must be filed if the trust has any taxable income for the year or gross income of $600 or more."

Turnipseed concluded, "Income is taxed to the trust or estate at special rates, unless distributed to the beneficiaries." In order to calculate the income taxation of trusts and estates one must: (1) "determine the fiduciary accounting income; (2) determine trust/estate taxable income before the distribution deduction; (3) determine the distribution deduction; (4) determine the trust taxable income; (5) determine the tax; and (6) allocate the income distributed to the beneficiaries and to the appropriate categories." ◆