



How to Shift Income to Beneficiaries

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Review of Materials

- Slides
- Technical materials: few thousand page PDF, only part of which supports the slides
- Look to cross-references from slides to PDF
- In **FULL TABLE OF CONTENTS**, go to part II.J. Fiduciary Income Taxation and its subparts





Navigate between Slides and Big PDF

- Open both documents
- Highlight cross-reference in slides
- Ctrl-c to copy
- Go to **FULL TABLE OF CONTENTS** in big PDF
- Ctrl-f to find
- Ctrl-v to paste
- Click ENTER to execute search (might need to specify “exact” or “whole word” search)
- Warning: search works only for to the fifth level of the heading, not the sixth, which ends in parentheses. For the latter, use the fifth level of the heading and scroll down just a little.





Overview

- Basics of how taxable items are allocated to a trust/estate or its beneficiaries
- Determine how health, education, maintenance, and support (HEMS) can be flexible and the estate and gift tax consequences of using HEMS or no standard
- Define what items comprise distributable net income (DNI) that is not necessarily fiduciary accounting income (FAI)
- Identify when capital gains are included in FAI and how to distribute capital gains





Trust Essentials

- Grantor
 - Person who makes gift to a trust
 - Also known as settlor, trustor, trustmaker
- Trustee
 - Person who administers, invests, and distributes assets
 - Your client for tax return preparation
- Beneficiary
 - Person who receives distributions
 - May or may not also be trustee



Polling Question 1

Who is NOT a grantor?

- Settlor
- Trustor
- Trustmaker
- Matchmaker





Trust Essentials

- Grantor trust
 - Grantor or perhaps a beneficiary is the deemed owner for income tax purposes
 - May be revocable or irrevocable
 - If wholly owned by deemed owner:
 - Might use deemed owner's tax ID
 - If use trust's tax ID, report items on grantor information statement
- Nongrantor trust – any trust that is not a grantor trust
- Estate
 - Probate estate of decedent's assets
 - Qualified revocable trust may elect treatment as an estate



Nongrantor trusts are the focus:

- Standards for making distributions
 - ascertainable standards (HEMS - health, education, maintenance, and support)
 - no standard at all (welfare or best interests)
- Distributable net income (DNI)
- Fiduciary accounting income (FAI)



Form 1041

Form 1041 U.S. Income Tax Return for Estates and Trusts		2025	OMB No. 1545-0002
Department of the Treasury—Internal Revenue Service Go to www.irs.gov/Form1041 for instructions and the latest information.			
A. Check all that apply: <ul style="list-style-type: none"> <input type="checkbox"/> Decedent's estate <input type="checkbox"/> Simple trust <input type="checkbox"/> Complex trust <input type="checkbox"/> Qualified disability trust <input type="checkbox"/> ESRT (S portion only) <input type="checkbox"/> Grantor-type trust <input type="checkbox"/> Bankruptcy estate—Ch. 7 <input type="checkbox"/> Bankruptcy estate—Ch. 11 <input type="checkbox"/> Pooled income fund 		For calendar year 2025 or fiscal year beginning <input type="text"/> 2025, and ending <input type="text"/> 20	
B. Number of Schedules K-1 attached (see instructions)		Name of estate or trust (if a grantor-type trust, see the instructions.) <input type="text"/> Name and title of fiduciary <input type="text"/> Number and street (if a P.O. box, see the instructions.) <input type="text"/> Room or suite no. <input type="text"/> City or town <input type="text"/> State or province <input type="text"/> Country <input type="text"/> ZIP or foreign postal code <input type="text"/>	
C. Check all that apply: <ul style="list-style-type: none"> <input type="checkbox"/> Initial return <input type="checkbox"/> Final return <input type="checkbox"/> Amended return <input type="checkbox"/> Described in sec. 4947(a)(1). Check here if not a private foundation. <input type="checkbox"/> <input type="checkbox"/> Described in sec. 4947(a)(2). <input type="checkbox"/> <input type="checkbox"/> Change in trust's name <input type="checkbox"/> Change in fiduciary <input type="checkbox"/> Change in fiduciary's name <input type="checkbox"/> Change in fiduciary's address 		D. Date entity created <input type="text"/>	
E. Nonexempt charitable and split-interest trusts, check applicable box(es). See instructions.			
F. Check applicable boxes: <ul style="list-style-type: none"> <input type="checkbox"/> Check here if the estate or filing trust made a section 645 election. <input type="checkbox"/> Trust TIN 			
Income	1	Interest Income	<input type="checkbox"/> 1
	2a	Total ordinary dividends	<input type="checkbox"/> 2a
	b	Qualified dividends allocable to: (1) Beneficiaries <input type="text"/> (2) Estate or trust <input type="text"/>	<input type="checkbox"/> 3
	3	Business income or (loss). Attach Schedule C (Form 1040)	<input type="checkbox"/> 4
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	<input type="checkbox"/> 5
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)	<input type="checkbox"/> 6
	6	Farm income or (loss). Attach Form 4797	<input type="checkbox"/> 7
	7	Ordinary gain or (loss). Attach Form 4797	<input type="checkbox"/> 8
	8	Other income. List type and amount	<input type="checkbox"/> 9
	9	Total income. Combine lines 1, 2a and 3 through 8	<input type="checkbox"/> 10
Deductions	10	Interest. Check if Form 4962 is attached <input type="checkbox"/>	<input type="checkbox"/> 11
	11	Taxes	<input type="checkbox"/> 12
	12	Fiduciary fees. If only a portion is deductible under section 67(e), see Instructions	<input type="checkbox"/> 13
	13	Charitable deduction (from Schedule A, line 7)	<input type="checkbox"/> 14
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see Instructions	<input type="checkbox"/> 15a
	15a	Other deductions (attach schedule). See Instructions for deductions allowable under section 67(e)	<input type="checkbox"/> 15b
	b	Net operating loss deduction. See Instructions	<input type="checkbox"/> 16
	16	Add lines 10 through 15	<input type="checkbox"/> 17
	17	Adjusted total income or (loss). Subtract line 16 from line 9	<input type="checkbox"/> 18
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	<input type="checkbox"/> 19
19	Estate tax deduction including certain generation-skipping taxes (attach computation)	<input type="checkbox"/> 20	
20	Qualified business income deduction. Attach Form 8995 or 8995-A	<input type="checkbox"/> 21	
21	Exemption	<input type="checkbox"/> 22	
22	Add lines 18 through 21	<input type="checkbox"/> 23	
23	Taxable income. Subtract line 22 from line 17. If a loss, see Instructions	<input type="checkbox"/> 24	
24	Total tax (from Schedule G, Part I, line 9)	<input type="checkbox"/> 25a	
25a	Current year net 965 tax liability paid from Form 965-A, Part II, column (k) (see Instructions)	<input type="checkbox"/> 25b	
b	First Installment of section 1062 applicable net tax liability. Enter amount from Form 1062, line 15	<input type="checkbox"/> 26	
26	Total payments (from Schedule G, Part II, line 19)	<input type="checkbox"/> 27	
27	Estimated tax penalty. See Instructions	<input type="checkbox"/> 28	
28	Tax due. If line 26 is smaller than the total of lines 24, 25a, 25b, and 27, enter amount owed	<input type="checkbox"/> 29	
29	Overpayment. If line 26 is larger than the total of lines 24, 25a, 25b, and 27, enter amount overpaid	<input type="checkbox"/> 30b	
30	Amount of line 29 to be: a Credited to 2026 <input type="checkbox"/> b Refunded <input type="checkbox"/>		
c	If completing line 30b, also complete lines 30c, 30d, and 30e.		
30c	Routing number <input type="text"/>	<input type="checkbox"/> Type: <input type="checkbox"/> Checking <input type="checkbox"/> Savings	
30d	Account number <input type="text"/>		
30e			
Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.			
Sign Here		Signature of fiduciary or officer representing fiduciary <input type="text"/> Date <input type="text"/> EIN of fiduciary if a financial institution <input type="text"/> <small>May the IRS discuss this return with the preparer shown below? See instructions. <input type="checkbox"/> Yes <input type="checkbox"/> No</small>	
Paid Preparer Use Only		Preparer's name <input type="text"/> Preparer's signature <input type="text"/> Date <input type="text"/> <small>Check <input type="checkbox"/> if self-employed</small> Firm's name <input type="text"/> Firm's address <input type="text"/> Firm's EIN <input type="text"/> Phone no. <input type="text"/>	
For Paperwork Reduction Act Notice, see the separate instructions. Cat. No. 11370H Form 1041 (2025) Created 10/29/25			

- General information
- Income
- Deductions
- Tax and Payments





Form 1041 – General Information

Form
1041

Department of the Treasury—Internal Revenue Service

U.S. Income Tax Return for Estates and Trusts

Go to www.irs.gov/Form1041 for instructions and the latest information.

2025

OMB No. 1545-0002

A Check all that apply:		For calendar year 2025 or fiscal year beginning _____, 2025, and ending _____, 20	
<input type="checkbox"/> Decedent's estate <input type="checkbox"/> Simple trust <input type="checkbox"/> Complex trust <input type="checkbox"/> Qualified disability trust <input type="checkbox"/> ESIT (a portion only) <input type="checkbox"/> Grantor type trust <input type="checkbox"/> Bankruptcy estate—Ch. 7 <input type="checkbox"/> Bankruptcy estate—Ch. 11 <input type="checkbox"/> Pooled Income fund		Name of estate or trust (If a grantor type trust, see the instructions.) Name and title of fiduciary	
		Number and street (If a P.O. box, see the instructions.)	Room or suite no.
		City or town	State or province
		Country	ZIP or foreign postal code
B Number of Schedules K-1 attached (see instructions)		F Check applicable boxes: <input type="checkbox"/> Initial return <input type="checkbox"/> Final return <input type="checkbox"/> Amended return <input type="checkbox"/> Change in trust's name <input type="checkbox"/> Change in fiduciary <input type="checkbox"/> Change in fiduciary's name <input type="checkbox"/> Change in fiduciary's address	
G(1) Check here if the estate or filing trust made a section 645 election		G(2) Trust TIN	





Form 1041 – Income

Income	1	Interest Income	1
	2a	Total ordinary dividends	2a
	b	Qualified dividends allocable to: (1) Beneficiaries _____ (2) Estate or trust _____	
	3	Business Income or (loss). Attach Schedule C (Form 1040)	3
	4	Capital gain or (loss). Attach Schedule D (Form 1041)	4
	5	Rents, royalties, partnerships, other estates and trusts, etc. Attach Schedule E (Form 1040)	5
	6	Farm Income or (loss). Attach Schedule F (Form 1040)	6
	7	Ordinary gain or (loss). Attach Form 4797	7
	8	Other Income. List type and amount _____	8
	9	Total Income. Combine lines 1, 2a, and 3 through 8	9





Form 1041 – Deductions

Deductions	10	Interest. Check If Form 4952 Is attached <input type="checkbox"/>	10
	11	Taxes	11
	12	fiduciary fees. If only a portion is deductible under section 67(e), see Instructions	12
	13	Charitable deduction (from Schedule A, line 7)	13
	14	Attorney, accountant, and return preparer fees. If only a portion is deductible under section 67(e), see Instructions	14
	15a	Other deductions (attach schedule). See Instructions for deductions allowable under section 67(e)	15a
	15b	b Net operating loss deduction. See Instructions	15b
	16	Add lines 10 through 15b	16
	17	Adjusted total income or (loss). Subtract line 16 from line 9	17
	18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18
	19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19
	20	Qualified business income deduction. Attach Form 8995 or 8995-A	20
	21	Exemption	21
	22	Add lines 18 through 21	22





Form 1041, Page 2

Form 1041 (2025)

		Page 2
Schedule A Charitable Deduction. Don't complete for a simple trust or a pooled income fund.		
1	Amounts paid or permanently set aside for charitable purposes from gross income. See Instructions	1
2	Tax-exempt income allocable to charitable contributions. See Instructions	2
3	Subtract line 2 from line 1	3
4	Capital gains for the tax year allocated to corpus and paid or permanently set aside for charitable purposes	4
5	Add lines 3 and 4	5
6	Section 1202 exclusion allocable to capital gains paid or permanently set aside for charitable purposes. See Instructions	6
7	Charitable deduction. Subtract line 6 from line 5. Enter here and on page 1, line 13	7
Schedule B Income Distribution Deduction		
1	Adjusted total income. See Instructions	1
2	Adjusted tax-exempt interest	2
3	Total net gain from Schedule D (Form 1041), line 19, column (1). See Instructions	3
4	Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4
5	Capital gains for the tax year included on Schedule A, line 1. See Instructions	5
6	Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6
7	Distributable net income. Combine lines 1 through 6. If zero or less, enter -0-	7
8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8
9	Income required to be distributed currently	9
10	Other amounts paid, credited, or otherwise required to be distributed	10
11	Total distributions. Add lines 9 and 10. If greater than line 8, see Instructions	11
12	Enter the amount of tax-exempt income included on line 11	12
13	Tentative income distribution deduction. Subtract line 12 from line 11	13
14	Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14
15	Income distribution deduction. Enter the smaller of line 13 or line 14 here and on page 1, line 18	15
Schedule G Tax Computation and Payments (see instructions)		
Part I – Tax Computation		
1	Tax:	
a	Tax on taxable income. See Instructions	1a
b	Tax on lump-sum distributions. Attach Form 4972	1b
c	Alternative minimum tax (from Schedule I (Form 1041), line 54)	1c
d	Amount from Form 4255, Part I, line 3, column (c)	1d
e	Total. Add lines 1a through 1d	1e
2a	Foreign tax credit. Attach Form 1116	2a
b	General business credit. Attach Form 3800	2b
c	Credit for prior year minimum tax. Attach Form 8801	2c
d	Bond credits. Attach Form 8912	2d
e	Total credits. Add lines 2a through 2d	2e
3	Subtract line 2e from line 1e. If zero or less, enter -0-	3
4	Tax on the ESBT portion of the trust (from ESBT Tax Worksheet, line 17). See Instructions	4
5	Net investment income tax from Form 8960, line 21	5
6a	Amount from Form 4255, Part I, line 3, column (f)	6a
b	Recapture tax from Form 8611	6b
c	Other recapture taxes	6c
7	Household employment taxes. Attach Schedule H (Form 1040)	7
8	Other taxes and amounts due	8
9	Total tax. Add lines 3 through 8. Enter here and on page 1, line 24	9

Form 1041 (2025)

- Schedule A - Charitable Deduction
- Schedule B – Income Distribution Deduction
- Schedule G – Tax Computation and Payments





Form 1041, Page 2, Schedule B

Schedule B Income Distribution Deduction	
1 Adjusted total income. See Instructions	1
2 Adjusted tax-exempt interest	2
3 Total net gain from Schedule D (Form 1041), line 19, column (1). See Instructions	3
4 Enter amount from Schedule A, line 4 (minus any allocable section 1202 exclusion)	4
5 Capital gains for the tax year included on Schedule A, line 1. See Instructions	5
6 Enter any gain from page 1, line 4, as a negative number. If page 1, line 4, is a loss, enter the loss as a positive number	6
7 Distributable net income. Combine lines 1 through 6. If zero or less, enter -0-	7
8 If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8
9 Income required to be distributed currently	9
10 Other amounts paid, credited, or otherwise required to be distributed	10
11 Total distributions. Add lines 9 and 10. If greater than line 8, see Instructions	11
12 Enter the amount of tax-exempt income included on line 11	12
13 Tentative income distribution deduction. Subtract line 12 from line 11	13
14 Tentative income distribution deduction. Subtract line 2 from line 7. If zero or less, enter -0-	14
15 Income distribution deduction. Enter the smaller of line 13 or line 14 here and on page 1, line 18	15

- Distributable net income (DNI) in line 7 includes tax-exempt items that are pulled out in line 14
- Distributions actually made or required to be made are added up in line 11 and reduced by tax-exempt items to get distributions in line 13 that may carry out income
- Income distribution deduction in line 15 is lesser of distributions in line 13 or DNI in line 14





Form 1041, Page 2, Schedule B Distributions

8	If a complex trust, enter accounting income for the tax year as determined under the governing instrument and applicable local law	8	
9	Income required to be distributed currently	9	
10	Other amounts paid, credited, or otherwise required to be distributed	10	

- Simple trust
 - Code § 651
 - Mandatory income (fiduciary accounting income – FAI)
 - No charitable distributions
 - No principal distributions
- Complex trust
 - May have mandatory or discretionary income and principal
 - If mandatory income, treatment of that income is similar to simple trust





Polling Question 2

What is a simple trust?

- Mandatory income, not to charity, no other distributions
- Mandatory income but might have above
- No trust is simple!



Form 1041 – Taxable Income

17	Adjusted total income or (loss). Subtract line 16 from line 9	17	
18	Income distribution deduction (from Schedule B, line 15). Attach Schedules K-1 (Form 1041)	18	
19	Estate tax deduction including certain generation-skipping taxes (attach computation)	19	
20	Qualified business income deduction. Attach Form 8995 or 8995-A	20	
21	Exemption	21	
22	Add lines 18 through 21	22	
23	Taxable income. Subtract line 22 from line 17. If a loss, see instructions	23	





Learning Objectives

- How HEMS can be flexible
- Estate and gift tax consequences of using HEMS or no standard
- What items comprise DNI that are not necessarily FAI
- When capital gains are included in FAI
- How to distribute capital gains
- How ownership of partnerships and S corporations complicates the interaction between DNI and FAI; what to do about it





What Income is Carried Out (II.J.8.f.)

- Deduct lesser of distributable net income (DNI) or actual or deemed (required) distributions
- DNI means the trust's taxable income, with certain modifications
- Whether the taxable income constitutes fiduciary accounting income (FAI) is irrelevant, except perhaps for capital gains
- Generally, FAI is relevant only for mandatory income trusts, in terms of what is deemed to be required



- As of date of owner's death, traditional IRAs payable to a trust are 100% principal but constitute DNI when distributed; post-mortem growth may be FAI or principal but are 100% DNI
- K-1 income from pass-through entity is DNI, but generally FAI is limited to part or all of cash distributions





Distributions after Yearend to Carry Out Income to Beneficiaries (II.J.4.a)

- Rough draft of return in February
- Compare to beneficiaries' tax rates/posture
- Distributions by 65 days after yearend (March 6, 2026 for 2025 returns) (II.J.2.)
- Distributions can carry out capital gains (see below)
- When in doubt (often still lack information by end of February), distribute extra (if also advisable for nontax reasons)
- When file return, can decide how much of post-yearend distributions to count for the year





Polling Question 3

What is distributable net income (DNI)?

- What Forrest Gump used to catch shrimp
- Any basketballs that make it through the hoop
- A trust's taxable income that is taxed to beneficiaries who actually received it or are deemed to have received it
- An extension (suffix) for an internet page



Charitable Distributions (II.J.4.c.)

- Although charities can be beneficiaries, distributions are deductions rather than carrying out income; charities do not get K-1s
- Distributions made by the end of the following taxable year may count as distributions for the current year
- Distributions must be made out of gross income and must be authorized under the trust agreement (except for contributions on a K-1 the trust received from a pass-through entity)
- Contributions offset income (including net investment income), which is better than an itemized deduction





Standards for Distributions

- Estate and gift tax concerns
- Nontax issues





Ascertainable Standard

Grantor trust purposes (III.B.2.h.vii.(a)) or gift tax purposes (II.J.2.b.):

- Education, support, maintenance, or health
- Reasonable support and comfort
- Accustomed standard of living
- Emergency





Gift tax issue:

- If beneficiary is the trustee and makes distributions to others than does or may diminish current or future distributions to that beneficiary, then those distributions may constitute a gift
- Because theoretically the other beneficiaries may enforce an ascertainable standard, a distribution under an ascertainable standard does not constitute a gift (per regulations)





Ascertainable Standard

Grantor trust purposes (III.B.2.h.vi.(a)) or gift tax purposes (II.J.2.b.) can't use:

- Pleasure, desire, or happiness
- Trustee's determination conclusive

Why not use? Beneficiary can't go to court and criticize trustee's decision



Ascertainable Standard

Estate tax purposes (II.H.2.k.):

- Health, education, support, or maintenance
- “Reasonably measurable in terms of his needs for health, education, or support (or any combination of them)”
- “Support” and “maintenance” are synonymous and not limited to the bare necessities of life



Examples for estate tax purposes:

- “Support”
- “Support in reasonable comfort”
- “Maintenance in health and reasonable comfort”
- “Support in his accustomed manner of living”





Examples for estate tax purposes:

- “Education, including college and professional education”
- “Health”
- “Medical, dental, hospital and nursing expenses and expenses of invalidism”



Estate tax purposes not ascertainable:

- “Comfort”
- “Welfare”
- “Happiness”



For estate tax purposes:

“In determining whether a power is limited by an ascertainable standard, it is immaterial whether the beneficiary is required to exhaust his other income before the power can be exercised.”





Polling Question 4

Which of the following is an ascertainable standard?

- Life, liberty, and the pursuit of happiness
- Health, education, maintenance, and support
- Welfare
- Best interests



Ascertainable standard:

Distributions for a person's "support" means distributions for a person's support and maintenance in reasonable comfort, medical care and education (including a course of instruction at an elementary school, secondary school, vocational school, art school, college, university, and graduate school, as well as private tutoring, internships and apprentice work). Distributions for the support of a beneficiary shall be based upon the standard of living to which such beneficiary shall have become accustomed. If and to the extent the power to distribute for support can be exercised to distribute assets to a new trust, the person holding this power may exercise it by modifying the existing trust rather than being required to distribute assets to a new trust.





Gorin Document Provisions (II.J.2.b.)

Not an ascertainable standard:

Distributions for a person's "welfare" means distributions for such person's comfort, welfare and best interests, all as determined in the trustee's absolute discretion. Pursuant to this standard, the trustee is authorized, in the trustee's absolute discretion, to determine that such person's welfare is enhanced by making a distribution to or for the benefit of such person of none, part or all of the trust. If and to the extent the power to distribute for welfare can be exercised to distribute assets to a new trust, the person holding this power may exercise it by modifying the existing trust rather than being required to distribute assets to a new trust.

"To or for the benefit of" is intended to authorize decanting
(II.J.18.c)



Gorin Document Provisions (II.J.2.b.)

Consideration of Other Resources:

In the exercise of the trustee's discretionary power to distribute income or principal of a trust for the support or welfare of any beneficiary, the trustee may consider the other income and financial resources known by the trustee to be reasonably available to such beneficiary, including the legal obligation of any other person to provide for such beneficiary's support. If the beneficiary fails to provide the information requested by the trustee, the trustee shall make such assumptions as the trustee deems appropriate. Except as specifically provided in this Agreement to the contrary, the trustee may either ignore the existence of such other income and financial resources in making the distribution or require the beneficiary to use all or any portion of such other income and financial resources as a condition to the distribution.

Client might vary if wants client beneficiary to have minimal access



When Sole Beneficiary is Sole Trustee

- Beneficiary can distribute income and principal for support
- Other trustee can distribute income and principal for welfare if not controlled by beneficiary



Distributions While Grantor Living

- Any trustee can distribute principal for support
- Any trustee can distribute income for support without triggering gift/estate tax consequences, but additional consideration is needed for grantor trust purposes





Distributions While Grantor Living

- Distributions for welfare should be reserved to trustee who is not grantor, not spouse, not beneficiary, and not related or subordinate to grantor
- But, if spouse is beneficiary, then grantor trust anyway (Code § 677), and need trustee who is not grantor and not controlled by grantor to distribute for spouse's welfare so income taxes can be paid



When Beneficiary Is Trustee

- Beneficiary who is trustee may distribute income and principal for beneficiary's support
- Trustee who is not beneficiary and not controlled by beneficiary may distribute income and principal for beneficiary's support (further caveats if grantor is living)



“Controlled” Trustee

- Trustee is deemed controlled by grantor or beneficiary if appointed by that person after the trust was created and the trustee is a related or subordinate party with the respect to that person
- See Section 11.5, “No Discharge Of Support Obligations And Other Limitations,” which is written for revocable trusts and needs to be modified for irrevocable trusts created during grantor’s life (II.J.2.b.)



Polling Question 5

Would you like to receive quarterly a free link to the then-most recent version of the few thousand page PDF that is included with the course materials, through Steve's newsletter, Gorin's Business Succession Solutions?

1. Yes
2. No
3. Already subscribe

Please be sure to download most recent version of PDF each quarter, read articles, or otherwise engage. Not engaging may deactivate subscription.



Flexibility in Trust Income Taxation

- Support – check for considering or ignoring other resources
- See whether distributions for welfare are permissible – check living client's estate plan for welfare and 5% withdrawal right (described further below)



Ideal Trust Distribution Provisions

- Distributions of income and principal for support
- Distributions of income and principal for welfare by independent trustee
- Consider 5% withdrawal right exercisable that trustee can turn off before the taxable year begins



Using Distributions for Welfare

- If appropriate, beneficiary can appoint person who is not a related or subordinate party (Code § 672(c))
- Distributions can carry out capital gain
- Can decant into more suitable trust or facilitate estate inclusion to get basis step-up at death



Additional Tax Issues

- Estate tax on beneficiary's estate – may be able to amend to grant formula general power of appointment
(II.H.2.k)
- Distribution in kind to include in beneficiary's estate for basis step-up
(II.J.8.d.)



Consider Trust Purposes

- Protecting beneficiary from third parties
- Protecting beneficiary from self
- Avoiding estate tax at beneficiary's death (increased exemption might change this need)



Protective Nature of Trust

- Very real creditor or spousal issues
- Burning a hole in the beneficiary's pocket
- Beneficiary saves but might one day have creditors





Polling Question 6

When should distributions be made?

- Any time the beneficiary wants money
- Only if authorized by trust agreement
- Whenever they save taxes
- After paying your fee





Top Bracket (II.J.3.)

	<u>2026</u>	<u>2025</u>
Single	\$640,600	\$626,300
Married filing jointly	\$768,700	\$751,600
Trust	\$ 16,000	\$ 15,900





Additional 5% Capital Gain Tax (II.J.3.)

	<u>2026</u>	<u>2025</u>
Single	\$ 545,500	\$533,400
Married filing jointly	\$ 613,700	\$600,050
Trust	\$ 16,250	\$ 15,900



Zero Capital Gain Rate (II.J.3.)

	<u>2026</u>	<u>2025</u>
Single	\$ 49,450	\$ 48,350
Married filing jointly	\$ 98,900	\$ 96,700
Trust	\$ 3,300	\$ 3,250





3.8% Tax on Net Investment Income (II.I.3.)

Single	\$200,000
Married	\$250,000
Trust	\$ 16,250
(\$ 15,900 for 2025)	

Indexed for trusts but not individuals



- Tax preparation software traps capital gain in the trust unless take special steps
- Next slides discuss strategic issues, law, and practical issues (II.J.8.)



Capital Gain is DNI Unless Excluded (II.J.8.a.)

Code § 643(a)(3): capital gain excluded from DNI only if:

- From sale of capital asset and allocated to corpus and not paid, credited, or required to be distributed to a beneficiary, or
- Paid, permanently set aside, or to be used for charitable purposes





Not a capital asset:

- Code § 1231 property
- Amortized goodwill (self-created goodwill not amortizable is a capital asset)

Thus, gain on sale is DNI even though it generally is principal





1. Allocated to income
2. Allocated to corpus but distributed consistently
3. 65-day rule distribution



- Trust agreement can allocate capital gain to income
- Cannot “depart fundamentally from traditional principles of income and principal” per Reg. § 1.643(b)-1
- 3%-5% should be OK



Allocated to Income (II.J.8.c.i.)

- “Power to adjust” principal
- Uniform Principal & Income Act reflects Prudent Investor Rule; UPIA becoming UFIPA (Uniform Fiduciary Income & Principal Act) (Uniform Law Commission adopted in 2018)
- No duty of consistency from year to year except unitrust



Polling Question 7

When would allocate capital gain to income?

1. Fairness - mandatory income
2. Save tax - discretionary distributions
3. Only if authorized





Resources

- Uniform Law Commission:
<https://www.uniformlaws.org/home>
- Web site for UFIPA:
<https://www.uniformlaws.org/committees/community-home?CommunityKey=1105f9bb-eb93-4d4d-a1ab-a535ef73de0c>
- Web site for UFIPA has a Documents tab, with a link to the [Enactment Kit](#) that includes mapping Principal & Income Act to its UFIPA counterparts



Power to Adjust (II.J.5.b.ii.(a).)

Under the Uniform Principal and Income Act, a trustee may adjust between principal and income to the extent the trustee considers necessary if:

- The trustee invests and manages trust assets as a prudent investor,
- The trust's terms describe the amount that may or must be distributed to a beneficiary by referring to the trust's income, and
- The trustee determines that the adjustment is necessary to fulfill the trustee's duty of impartiality between the beneficiaries.



Power to Adjust (II.J.5.b.ii.(a).)

- UFIPA § 203(a) requires only that the trustee determine that “the exercise of the power to adjust will assist the fiduciary to administer the trust or estate impartially.”
- Thus, UFIPA requires only that the power to adjust will be helpful, not necessary.
- UFIPA - trustee not liable for failing to exercise the power
- UFIPA - trustee not liable for decision in good faith



Power to Adjust (II.J.5.b.ii.(a).)

Factors a fiduciary must consider (adjust or unitrust):

- the terms of the trust
- the nature, distribution standards, and expected duration of the trust
- the effect of the allocation rules, including specific adjustments between income and principal, under Articles 4 through 7
- the desirability of liquidity and regularity of income
- the extent to which an asset is used or may be used by a beneficiary
- the increase or decrease in the value of principal assets, reasonably determined by the fiduciary





Power to Adjust (II.J.5.b.ii.(a).)

Factors a fiduciary must consider (adjust or unitrust):

- whether and to what extent the terms of the trust give the fiduciary power to accumulate income or invade principal or prohibit the fiduciary from accumulating income or invading principal
- the extent to which the fiduciary has accumulated income or invaded principal in preceding accounting periods
- the effect of current and reasonably expected economic conditions
- the reasonably expected tax consequences of the exercise of the power



Power to Adjust (II.J.5.b.ii.(a.)

A fiduciary cannot adjust if would:

- Reduce the amount payable to a current income beneficiary from a trust that qualifies for a special tax benefit, except to the extent the adjustment is made to provide for a reasonable apportionment of the total return of the trust between the current income beneficiary and successor beneficiaries
- Change the amount payable to a beneficiary as a fixed annuity or a fixed fraction of the value of the trust assets under the terms of the trust
- Affect charitable set-aside





Power to Adjust (II.J.5.b.ii.(a).)

A fiduciary cannot adjust if adjusting would:

- Cause a person to be treated as the owner of all or part of the trust for federal income tax purposes (but can appoint special trustee)
- Cause all or part of the value of the trust assets to be included in the gross estate of an individual for federal estate tax purposes (but can appoint special trustee)
- Cause an individual to be treated as making a gift for federal gift tax purposes (but can appoint special trustee)
- Be done by fiduciary who is not an independent person
- Affect eligibility for public benefits
- Change a unitrust



Unitrust (II.J.5.b.ii.(b).)

- A fiduciary cannot convert to, modify, or turn off unitrust if would violate certain tax rules
- If trust qualifies for a special tax benefit or a fiduciary is not an independent person, then the unitrust rate must be 3%-5%
- Terms of the trust may write rules, in whole or in part
- Trustee adopts unitrust policy, including:
 - the unitrust rate or the method for determining the unitrust rate
 - the method for determining the applicable value
 - the application of certain mandatory or permissive rules



Unitrust policy may include:

- Provide methods and standards for:
 - Determining the timing of distributions;
 - Making distributions in cash or in kind or partly in cash and partly in kind; or
 - Correcting an underpayment or overpayment to a beneficiary based on the unitrust amount if there is an error in calculating the unitrust amount;
- Specify sources and the order of sources, including categories of income for federal income tax purposes, from which distributions of a unitrust amount are paid; or
- Provide other standards and rules the fiduciary determines serve the interests of the beneficiaries





Comparing Power to Adjust to Unitrust (II.J.5.b.ii.(c).)

- Generally, a fiduciary exercises the power to adjust annually and the power to modify a unitrust only once or occasionally
- Exercising a power to adjust generally is included in annual reports, whereas adopting, modifying, or revoking unitrust provisions requires specific notice to the beneficiaries
- However, UFIPA allows a power to adjust to apply to all future periods and also authorizes frequent changes to a unitrust policy, so the above generalization about frequency is not necessarily accurate
- Unitrust probably generates capital gain on distribution in kind (definitely does for CRUT)
- Power to adjust more flexible for tax planning



Allocated to Corpus But Distributed Consistently (II.J.8.c.ii.)

- Existing trusts – probably did NOT allocate capital gain to DNI
- Solution discussed later
- New trusts – generally allocate capital gain to DNI unless beneficiary in higher federal & state combined bracket (including phase-outs)



Actual or Deemed Distribution

(II.J.8.c.iii.)

- Tracing actual distribution often not practical unless terminate trust
- Referring to capital gain suffices – 65-day rule distribution when trustee refers to capital gain
- Can be inconsistent from year to year



- Fair for cash distribution to carry out taxable income
- If not, “gross up” distribution for taxes paid by distributee
- “Gross up” payment costs remaindermen less than if the trust paid the tax



Polling Question 8

How flexible is including capital gains in DNI so that they can get passed out to beneficiaries?

- Capital gains are always in DNI
- Capital gains are never in DNI
- One always has to choose the first year and always be consistent thereafter
- Some capital gains are always in DNI, and others may be in DNI (depending on the extent to which any of 3 tests applies)





K-1s vs. Distributions from Business Entities (III.A.4.)

- K-1 income from pass-through entities tends to exceed distributions
- To shift taxation to beneficiaries may require the trustee to make distributions from other sources
- Exception – QSST (III.A.3.e.)



Distributions from Business Entities

UFIPA retained some and improved on other aspects:

- Uniform Principal & Income Act § 505, now UFIPA § 506, continues to allow the trustee to pay taxes on K-1 income from pass-through entities before making income distributions
- UFIPA § 401 retained basic principles but provides a lot more flexibility for the trustee to characterize distributions as income or principal, based on various facts and circumstances that the trustee knows or infers





Distributions from Business Entities

(III.A.4.)

- Circular calculation
- Paying taxes must take priority over making distributions to beneficiary
- Fairness? Compare pass-through reinvestments to C corporation reinvestments, the latter being “out of sight, out of mind”
- Might need to sell asset
- Equitable adjustments (II.J.12.)





Conclusion

- [Gorin's Business Succession Solutions](#) (quarterly updates to several thousand page materials plus chance to subscribe to other publications)
- CPA Academy [webinar page](#), including:
 - Grantor Trust Rules
 - Fiduciary Income Tax Refresher and Update 2026
 - Pass-through Entities Held By Trusts
- Other [free Thompson Coburn LLP resources](#)