3.8% HEALTHCARE SURTAX
ESTATE AND TRUST CHECKLIST

1. **Did you consider making a Section 645 election in 2012 to treat the estate and trust as one entity?**
    a. Allows for the choice of year end
    b. No estimates for two years
    c. Election is only available on initial return
2. **Should you make distributions during calendar year 2012 or fiscal year 2011 to "shift" income from the estate/trust to the beneficiary?**
    a. Example – Tom, age 25, is a beneficiary of a calendar year trust created in 1987. The trustee wishes to make a distribution to fund Spring 2013 tuition. If the distribution occurs in 2012 no surtax exists. If the distribution occurs in 2013, DNI is shifted from the trust to Tom. If Tom's income exceeds $200,000, the surtax will be imposed.
    b. Consider using the 65 day rule under Section 663(b)
    c. Note that the surtax would apply at the beneficiary level only if the trust distributed net investment income to the beneficiary, and the beneficiary's income exceeded the threshold amount.
3. **Consider selecting a year-end of September, October or November 2012 . This will allow the estate to avoid the surtax until later in 2013. Under Section 1411 the surtax only applies to years beginning on or after January 1, 2013.**
    a. Generally, the ideal year end will be November 30, 2012
    b. Some exceptions will likely exist
    c. Note that a fiscal year-end is only available for recent deaths.
4. **Consider funding pecuniary clauses before the estate/trust is subject to the surtax. The funding of a pecuniary bequest (e.g. "that dollar amount which results in no federal estate tax") can result in the acceleration of gain upon funding.**
    a. Example – Clair died in late 2009 and assets have not been transferred from her estate. The estate is on a calendar year. If funding occurs in 2012, and a $500,000 gain is accelerated in 2012, the federal tax rate will be 15%. If trust funding occurs in 2013, the tax rate will be 43.4% (39.6% +3.8%) for short term gain, or 23.8% (20%+3.8%) for long-term gain.
    b. The same result could be accomplished for the funding of a residuary bequest if a 643(e) election is made.
5. **Consider the proper investments for estates and trusts to avoid the imposition of the surtax.**
    a. Reduce Taxable Interest Income
        i. Tax-Exempt Bonds
        ii. Tax-Deferred annuities

   b. Reduce Capital Gains
      i. Low Turn-Over Funds
      ii. ETFs
      iii. Similar Strategies
   c. Review the Role of Life Insurance
      i. Tax Deferred Growth
      ii. Lifetime Tax-Free Recovery of Basis
      iii. Tax-Free Death Benefit
   d. Review Proven Tax Shelters
      i. Master Limited Partnerships
      ii. Real Estate
      iii. REITs
      iv. Oil and Gas

6. **Allocation of Trust Income**
   a. The surtax applies only to a trust's undistributed net investment income (IRC § 1411(a)(2)).
   b. Deductions can be used to reduce net investment income (IRC §1411(c)(1)(B)).
   c. A trustee has some discretion in deciding how to charge indirect expenses to various classes of income, although some amount must be allocated to any tax-exempt income earned during the year (Reg. § 1.652(b)-3(b)). Note: A trustee must allocate direct expense to the income that generated the expense.
   d. Thus, it appears that a trustee could allocate trust expenses to minimize the amount subject to the surtax to some extent
      i. E.g., expenses could be allocated to interest first, then rents, then dividends and finally to business income.
   e. Trustee could also leave more dividend income in the trust if such income still qualified for the current 15 percent rate in 2013.
   f. May be possible to program your software to make favorable allocations of expenses.
   g. If trust has no business income, allocation of investment income wouldn't matter.
   h. Caveat: Can trusts allocate miscellaneous itemized deductions to reduce net investment income?

7. **Early QSST election for Estates**
   a. Making the QSST election passes estate income out to the beneficiaries.
   b. This is favorable because the beneficiaries will generally have a much higher applicable threshold amount than the estate.
   c. Thus, the QSST election should be made as early as possible

8. **S Corporation Notes Payable to Shareholders**
   a. Interest income would be NII
   b. Offsetting expense is on Schedule E
   c. Should shareholders borrow the money personally?

9. **Self-rental real estate**
    a. Should we maximize rental income paid to the shareholder/owner?
    b. Net of this Schedule E item would be subject to NII
    c. Maybe we should minimize the rental income and increase shareholder distributions to make up for the case difference.

This is a surtax specific checklist and does not replace a comprehensive AICPA or other Fiduciary Income Tax checklist

For discussion purposes only. This work is intended to provide general information about the tax and other laws applicable to retirement benefits. The author, his firm or anyone forwarding or reproducing this work shall have neither liability nor responsibility to any person or entity with respect to any loss or damage caused, or alleged to be caused, directly or indirectly by the information contained in this work. This work does not represent tax, accounting, or legal advice. The individual taxpayer is advised to, and should rely on, their own advisors.