

CALIFORNIA STATE UNIVERSITY, NORTHRIDGE

DESIGN OF AN INTEGRATED EXPERT SYSTEM
FOR FIDUCIARY ACCOUNTING

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requirements for the degree of Master of Science in

Accountancy

by

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ABSTRACT

DESIGN OF AN INTREGATED EXPERT SYSTEM FOR FIDUCIARY ACCOUNTING

by

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Master of Science in Accountancy

This research was conducted in order to deal with the apparent lack of general expertise pertaining to the fiduciary responsibility associated with the administration of a decedents estate. The administration has legal, accounting, and income tax aspects. This paper has attempted to integrate these aspects and provide the framework necessary to solve the defined problem by development of an expert system. The model takes a modular approach; to develop a decision support system (tier 1) from which the expert system (tier 2) can ultimately be derived. The paper presents a detailed analysis of the legal and accounting, as well as the income tax parameters of the fiduciary responsibility functions. In addition, systems considerations are addressed, additional research proposed, and finally conclusions

are presented.

CHAPTER 1

Introduction

Environment

There is little doubt that the tremendous advances in computer technology are changing both our private and professional lives. The accelerating pace of this technological development directly affects our lives in terms of its economic, social, and political aspects. Information systems are providing more varied information which is being delivered at a more rapid pace to an ever increasing variety of users. The integration of computer, satellite and telecommunication technologies has generally been responsible for this rapid flow of information, which has been characterized as the Information Age. All sectors of society are seeking more information.

The value of generating useful information is without any doubt. The business community places a high value on up-to-date data to facilitate the making of decisions as well as for problem solving. This rapid technological development has resulted in an ever increasing demand for information specialists, individuals responsible for sorting and selecting information as well as creating new informational systems.

The accounting profession and its members are certainly not sheltered from the impact of this technological development. The American Institute of Certified Public Accountants

(AICPA) is preparing to offer certificate courses in microcomputer consulting, and is studying the possibility of recognizing tax areas for specialty designations. The AICPA recently introduced a computer application program known as the Audit Program Generator, a flexible audit program creator which some might view as a rudimentary form of artificial intelligence. In addition, decision support systems are becoming more and more complex, and the application software uses in accounting are expanding, especially in the field of taxation. The boundaries of the accounting profession are being expanded by an ever increasing sophistication in the application of computer technology. Therefore, any project which encompasses expert systems, financial accounting and taxation is certainly timely. It is from this environment that the subject of this paper has been drawn. This paper represents an attempt to address these topics of current interest, but viewed from the relatively narrow field of fiduciary accounting.

Topic Definition

The title of this paper, "Design of An Integrated Expert System for Fiduciary Accounting", now requires an elaboration on the scope of the meaning of its terms. The term fiduciary accounting will be limited to the financial, legal and income tax aspects of the fiduciary responsibility associated with the estate of a decedent. Integration refers to the common linkages between the above aspects of fiduciary accounting. Expert system represents the specific sub-area of artificial

intelligence that deals with the computer utilization of expert knowledge to perform problem solving tasks. Finally, design means a discussion of the methodology appropriate for developing an expert system specific to the needs of the fiduciary responsibility of a decedent's estate.

Topic Overview

Fiduciary accounting is a general term that focuses on accounting for transactions involving some form of fiduciary relationship between various interested parties. This concept is closely related to the legal basis upon which the fiduciary relationship is created. The type of legal relationship at issue here is that of an estate. An estate being a gathering of assets into a legally created entity to enable the courts to administer there disposition. An estate can take many forms including, for example, a bankruptcy estate. But the estate of interest here is that of a decedent. Upon an individuals death their assets are inventoried and an estate tax is computed based upon the gross value of the estate properties. In addition, the estate must account for its activities during the administration of the estate, and report any income earned during that administration. It is this administration period that, from death until final distribution of all assets to any beneficiaries, that will be discussed. In the papers title, fiduciary accounting has a broad meaning, yet the true topic will center on what might be called fiduciary responsibility. This term encompasses the three aspects of a decedents estate: the legal (court)

requirements, the financial accounting needs, and the income tax compliance concerns.

Problem Definition, Solution and Justification

There has been little, if any, attention paid to this topic from an integrated systems application point of view. Yet, most practicing accountants believe that this topic, specifically estate income taxation and its associated legal reporting requirements are too complex to understand and therefore should be avoided. Internal Revenue Service personnel in the majority of cases possess little knowledge of this topic. In addition, most individuals charged with responsibility for administering estates have little understanding of the intricacies of their fiduciary responsibilities. This lack of understanding by all of those dealing with estates may be partly due to the fact that it is not a typical everyday event, at least for most people. Therefore this general lack of knowledge would appear to make this topic especially well suited for developing a computer assisted solution.

The solution being proposed centers on developing an integrated expert system. The task of developing a true expert system is extensive, but could be accomplished by a two tier modular approach. The first step in the developmental process would consist of the following:

Problem definition.

Research of legal, accounting and income tax aspects.

Itemized detailed relationships and requirements.
Identify integration (interface) points.
Design system features (e.g. menu, formats, etc.).
Program and debug.

This first step would result in an integrated application software program. The problem definition at this level is mostly concerned with compliance features, that is, given certain stated input data specific results should be outputted. Some expert knowledge is required to make decisions in terms of determining the appropriate responses to the input inquiries.

The second tier of the modular approach would consist of the following:

Problem definition.
Itemize decision input variables.
Research decision criteria.
Integrate input variables with decision criteria.
Develop programming.

The problem definition at this level is concerned with identifying the input variables and then establishing the decision making criteria. This module replaces the expert knowledge required in tier one above.

The model that the first module would be developed from is not the traditional abstract representation of some complex system. It represents the more absolute view of the logical structure of the real world. Module two would encompass a more abstract model form, due to the many more vari-

ables that would have to be incorporated into it.

This paper will take the proposed developmental process through the design of systems features found in tier one. The goal is to provide a basis for further research and development. Due to time constraints module one will not be actually programmed. This is because any competent programmer could perform this profunctuary task once the logical structure of the system has been established. The development of tier one, in and of itself, provides users with a useful decision support system, though it would require relatively sophisticated users. It then provides a basis for further development and expansion into an expert system. This expansion is left to further research.

The modular approach proposed can best be viewed by example. In tier one someone would find it necessary to be able to distinguish between taxable and non-taxable income. Once determined though, the system would properly handle reporting of the decision. The addition of tier two would provide the user with decision making assistance in determining whether a particular item of income was taxable or not. This approach of developing a compliance model and then adding the higher level of artificial intelligence concept is similar to the expressed intent of artificial intelligence, to make a computer system operate in a manner comparable to the human brain. The brains core controls basic body functions (tier one) and the higher level conceptual functions (tier two) are developed around this core.

The reason why this research is so appropriate is twofold. First, the specific approach to the topic is unique and second, the potential beneficiaries of its implementation are numerous. The approach is unique in that it addresses the integration of the various aspects of the fiduciary responsibilities associated with a decedents estate. Those aspects being the financial accounting, legal and income tax segments. Certainly there are application programs that deal with estates, but most of these programs deal with estate planning. The emphasis in those cases is on the estate tax due upon an individuals death, not the income tax that results during the administration of the estate. Many software producers that deal in tax return preparation have begun introducing application programs that prepare fiduciary tax returns, but there is no integration with the financial and legal aspects of the overall fiduciary responsibility. The potential beneficiaries of this research, especially with development of a working decision support system, would include accountants, lawyers and courts, estate administrators, the Internal Revenue Service, and trust officers of financial institutions. A completely integrated expert system would expand the pool of users to include more unsophisticated individuals. The expert system application increases potential users to anyone with a need to analyze estate transactions. This research could also assist educators in integrating the various aspects of a decedents estate into their curriculum.

CHAPTER 2

Fiduciary Responsibility: Legal and Accounting

Legal Background

In order to design the system that is being proposed in this paper, first an examination of the components that comprise the fiduciary responsibility functions of a decedent's estate must be made. The components that are to be discussed in this chapter are the legal and accounting aspects. These items are being discussed in conjunction with each other because they are inexorably linked. This is because the financial accounting functions are generated by the legal requirements placed upon the fiduciary of the estate, generally through reports to the court and beneficiaries. A properly designed model must maintain an accounting system that satisfies all the requirements of the fiduciary state laws, the governing instrument (the will), and the court. Each state's laws concerning estate administration are similar in nature but unfortunately are varied enough that this presentation will focus on the laws of California.¹ The accounting system should help to protect the fiduciary, as well as all interested parties, and enable the fiduciary and his advisors

1. All subsequent discussions of probate code refers to the 1987 California Probate Code, Division 3, Administration of Estates.

to render all necessary information and reports.

An estate comes into being upon the death of an individual who owns property.² It is a legal entity into which the decedents property is automatically transferred by operation of the law.

The estate is typically administered and represented by an executor who has been named in the decedents will. If the decedent died without a will, then usually the court appoints a legal representative called an administrator as a result of a petition filed by the decedents next of kin. Whether an executor or an administrator, the legal representative of an estate is charged with the task of collecting and conserving all assets, satisfying liabilities, including taxes, and distributing any remainder to the appointed heirs.³

Probate

When a person dies his property comes immediately under the jurisdiction of the probate court of the county in which the deceased was a resident. In Los Angeles County the probate court is a division of the Superior Court of the County of Los Angeles. A petition to the court of proper

2. Rufus Wixon et al., Accountants' Handbook, 5th ed. (New York: Matthew Bender, 1970), 25.26.

3. Charles H. Griffin et al., Advanced Accounting, 4th ed. (Homewood, Illinois: Richard D. Irwin, 1980), 741-742.

jurisdiction by any parties having an interest in the estate begins estate proceedings. If there is a will, such a petition is known as a Petition for Probate of Will.⁴

The will must be ruled valid, or admitted to probate, by the court before it becomes operative. If, after witnesses to the signing of the will testify in hearings, the court is satisfied that the will is genuine, that the decedent was legally competent, and that it represents the last expression of the decedent relative to the distribution of his property, the probate court will order that the terms of the will be carried out.

The court will appoint the person named in the will to act as the executor. As evidence of his authority to act as executor of the estate, the court will issue Letters Testamentary. If no executor is named, then the court will appoint a person to act in this capacity. This individual is known as an administrator and will issue Letters of Administration as evidence of his authority.⁵ In either case the will acts as the governing instrument to determine how the assets are to be distributed. Where a person dies

4. Joseph K. Del Torto, interview with author, 9 September 1987.

5. Arnold W. Johnson, Advanced Accounting (New York: Rinehart and Company, 1948), 450-451.

without a will, the court will appoint an administrator. Without a will, the governing instrument is state law. The state law (which is rather complex) that determines how the decedents assets are to be distributed is known as the law of intestate (without will) succession.

It should be pointed out that this process of issuing letters can be lengthy and therefore a complete record should be kept of all transactions occurring prior to the issuance of letters. Any recording of these transactions will not be entered into the formal records until after issuance, but should bare the date upon which the transaction actually occurred. Any expenses in connection with this probate process and obtaining copies of the letters constitute part of the administration expenses.⁶

Non-probate Assets

Before discussion of how and what assets are administered by the probate estate perhaps we should look at what are referred to as non-probable assets. Non-probable assets are those items of property that the decedent owns that pass outside the estate by action of the law.

Non-probable assets include:

Property held by title: joint tenancy with right
of survivorship (passes by operation of law to
the surviving joint tenant outside of

6. Wixon et al., 25.26.

probate).

Property held by title: community property with surviving spouse (passes to surviving spouse to extent spouse is entitled to such assets outright by will or succession).

Life Insurance and Annuities (bypass probate administration provided policy beneficiary is not the decedent or his estate).

Assets subject to trusts created during decedents lifetime (either revocable or irrevocable trusts bypass probate administration).

Assets transferable under California Probate Code Section 630, et seqq. (generally allows extremely small estates to bypass probate administration).

Totten trusts, Paid-on-Death accounts, U.S. savings bonds, social security and veterans administration death benefits.

While the above items pass outside of probate administration they still require the filing of legal documents and are subject to court authority. For example, the community property exception requires a court hearing (in the probate court handling the balance of the estate) wherein the court can issue an order determining that property is community property belonging to a surviving spouse and that no administration is necessary prior to delivery of the property.

It is important to note that while joint tenancy

property and life insurance payable to a specific beneficiary other than the estate is not a part of the probate estate, it is a fairly common practice to include these items in the inventory of assets (discussed in detail later) with specific language indicating it is being placed there as matter of convenience. This is especially true of joint tenancy property.

Estate Administration

Upon appointment by the court, the executor or administrator (representative) becomes responsible for the collection, conservation, and distribution of the decedents property. The representative begins by preparing an inventory and appraisal of the estate properties to be used for court, accounting, and tax purposes. He pays legal, funeral and administrative expenses, debts of the decedent, federal estate and income taxes, and other expenses. After payment of all estate expenses and debts are provided for, the representative distributes the remaining properties to the legal beneficiaries. Finally, he must provide an accounting of estate transactions to the court and to any other parties with an interest in the estate administration and asset distribution.

Asset Inventory

The representative begins by seeking out and taking possession of the property of the decedent. He is required to exercise due diligence in the discovery of assets, and he is empowered to take all proper legal actions to obtain posses-

sion of them.⁷ The properties that come under his authority and control must be prudently managed, protected and conserved until they are distributed. Barring any special instructions in the will or by the court, the representative will usually not invest estate funds or operate any businesses left by the decedent.

If the estate includes a partnership interest, then the partnership will be liquidated in the absence of special provisions in the will or in the partnership agreement.⁸

State laws specify those assets which will pass directly to the beneficiaries in accordance with the will or by succession and those items which pass to the estate for administration. Usually, state law provides that title to real property passes directly to the legal beneficiaries immediately upon the death of the decedent and personal property passes into the possession and control of the representative. However, certain specific items of personal property may be exempted by statute for the benefit of the surviving spouse or of the decedents children.⁹

7. Walter B. Meigs et al., Advanced Accounting (New York: McGraw-Hill, 1966), 796.

8. Griffin et al., 743.

9. Harry Simons and Wilbert E. Karrenbrock, Advanced Accounting - Comprehensive Volume, 4th ed. (Cincinnati:

The legal representative is usually required to submit to the probate court an inventory of all the assets taken over, which will form the basis of the accounting of the representative. Normally, real and personal properties that pass directly to the beneficiaries are not included in the decedents inventory, where the inventory represents those assets for which the representative is held responsible for by law. But often courts will request that such items be included for informational purposes. It may be in the best interest of the fiduciary to include schedules listing real and personal properties excluded from the estate but which are noted in the inventory so that the court may be informed of all the properties left by the descendant.¹⁰

A complete and detailed description should be provided for each property item in the inventory, and values must be assigned as well. The representative will usually be able to arrive at satisfactory valuation for most of the items in the inventory, such as with use of current market quotations. Certain assets may require consultation with outside experts, such as brokers and appraisers. The values are determined as of the date of the decedents death and presumably represent

South-Western Publishing, 1968), 737.

10. Simons and Karrenbrock, 737.

the fair market value as of that date. These values are also normally used for federal estate tax purposes as well, and the inventory details should be incorporated into the estates accounting system.

The inventory should include, among other things, the following:

Cash: in possession of decedent, checking, savings certificates of deposit, money market, etc.

Tangible personal property: motor vehicles, household furnishings, collectibles, furs, jewelry, clothing, etc.

Intangible personal property: patents, copyrights trademarks, leases, judgments, other legal rights, etc.

Investments: mutual funds, stocks and marketable securities, bonds, commercial paper, U.S. treasury notes and bonds, notes and loans receivable, options and futures contracts, limited partnerships, etc.

Real Property (required to be included by the will or law): residence, income producing property, unimproved land, etc.

Other: life insurance payable to estate, net cash value of life insurance owned by others, general partnerships, business interests (farm, sole proprietorship, closely held corporation, etc.), retirement accounts

(IRA, KEOGH, pension, profit sharing, 401K, etc.), interest in trusts or other estates, accrued income (wages, commissions, interest and dividends, rent, accounts receivable, etc.), etc.

California Probate Code Section 600 specifies that the inventory and appraisement must be filed within three months of appointment of the fiduciary.

Claims Against the Estate

One of the important functions of the fiduciary is to insure that all debts of the estate are fully satisfied. All legitimate claims against the estate must be paid before any property can be properly distributed to the beneficiaries. State laws generally provide a limited time period within which creditors of the decedent may file their claims or else risk forfeiture of any legal right they may have to collect. Ordinarily, laws require that the representative advertise for claims by proper legal notices for a specified period of time. In California, Probate Code Section 700 identifies the proper form for notifying creditors and it is known as the Notice to Creditors. The notice must be published in a newspaper once a week for four weeks and the newspaper must file an Affidavit of Publication. The general rule is that claims must be filed or presented within four months of the first publication of notice to creditors or the claim is barred. There are exceptions, which are generally taxes.

Claims against the estate are submitted through the

court or are presented to the fiduciary directly. It is the responsibility of the representative to approve or reject the claims. California Probate Code Section 710 and 711 specify that approved claims are filed and presented to the court for final approval or rejection. The procedure for handling claims that the representative has rejected are dealt with in Probate Code Section 714. This section requires the preparation of the Rejection of the Claim and the Notice of Rejection, which must be served upon the claimant. The original notice along with the proof of service are filed with the court. For claims that have been disallowed, the claimants still have the ability to bring suit against the representative or to make claim upon the estate when the fiduciary files his accounting with the court.

Once a claim has been allowed, it should be paid "in due course of administration", as it is known in legal parlance. The law provides that claims against the estate shall have a specified priority, which identifies those claims that must legally be paid before others can be. This concept is especially important when the assets of the estate are insufficient to meet all the estate debts. The Probate Code, Section 950, provides the following priority for payment of debts:

Expenses of administration.

Funeral expenses.

Expense of last illness.

Family allowance.

Debts having preference by the laws of the United States.

All other debts.

Taxes paid by the estate are an important category of estate obligation. The representative is responsible for settlement of all taxes relating to both the decedent and his estate, including income taxes, estate tax, and possible inheritance tax. The fiduciary must pay, from estate assets, income tax on the decedent's income for the period from the date of the last personal income tax return filed by the decedent to his death. Any refund that may result is payable to the estate. In addition, the estate must pay income tax on the income of the estate generated during the time of its administration. This income tax and the return to be filed, a fiduciary income tax return, is the topic of discussion in the next chapter of this paper.

The federal estate tax (reported on federal form 706) is an assessment against an individual's ability to transfer his estate to others upon his death. This tax is based upon the decedent's gross estate less certain allowable deductions and exemptions.¹¹ A decedent's gross estate for tax purposes includes all property in which the decedent had a legal interest, including real and personal property, whether tangible

11. Sidney Davidson, Handbook of Modern Accounting (New York: McGraw-Hill, 1970), 44-3.

or intangible. The values used in arriving at the gross estate are the fair market values as determined by the fiduciary, in a manner similar to the values used in the probate inventory and appraisal. In fact, the values determined by the representative are usually used for both purposes. The assets included in the taxable gross estate are all inclusive, this means that even those assets that legally bypass probate are reportable in the gross estate for tax purposes. This is one good reason why it is often the case that non-probate assets are included in any court accounting as a memorandum notation, since the information is available due to the need to report it on the tax return. The fiduciary has an option with regards to the values used in the gross estate for tax purposes, namely he may elect to use an alternative valuation date six months after the date of death. The deductions allowed from the gross estate include: funeral and administration expenses, professional and fiduciary fees, claims against the estate, unpaid mortgages, charitable bequests, and an unlimited marital deduction for certain properties passing to a surviving spouse. The gross estate less the allowable deductions is equal to the taxable estate. Estate tax rates are then applied to the taxable estate to arrive at the tentative estate tax. A credit for state death taxes paid, to a specific maximum, is allowed against the tentative tax. Finally a credit, known as the unified credit, is deducted from the tentative tax leaving a net tax for which the estate is li-

able. The unified credit against the tax has a deduction equivalence of \$600,000, assuming the decedent has not used any of his credit through lifetime gifting.

Most state inheritance taxes are a levy on the beneficiaries right to receive a distribution from a decedent's estate. Fortunately, California no longer has an inheritance tax. It does have what is called a pick-up or piggyback tax, that is, a tax is assessed to the extent that a state death tax credit was allowed on the federal estate tax return.

Estate Distributions

Generally, the title to personal property passes to the estate fiduciary and from him to the individual beneficiaries. Title to real property usually passes directly from the decedent at his death, to the individual beneficiary by condition of the will or by law unless it specifically becomes part of the estate by will or the court includes it in the estate to satisfy debts of the estate.¹² From the assets included in the estate all the debts and claims against the estate are satisfied. Once appropriate provision has been made for payment of all obligations against the estate, the representative can begin to distribute the remaining estate properties.

When a decedent leaves a will, any distribution of per-

12. Simons and Karrenbrock, 741.

sonal property according to the terms of the will is known as a bequest. Where the terms of the will dispose of real property, the disposition is known as a devise. Disposition of personal property according to the terms of a will are categorized and paid in the following order:

Specific bequest: disposition of particular items.

For example: "My 57 shares of Class A preferred stock of ABC Company".

Demonstrative bequest: disposition of cash or other personal property payable from a particular fund or asset accumulation. For example: "The sum of \$500 to be taken from the proceeds of sale of my 100 shares of common stock of the XYZ Company".

Annuity: dispositions payable over a specified period of time. For example: "the sum of \$900 per year, payable every six months, for life".

General bequest: dispositions not specifically designated, payable from the general estate assets. For example: "the sum of \$10,000 in cash", or "100 shares of the common stock of the PDQ Corporation".

Residuary bequests: dispositions of the personal property remaining after all other bequests. For example: "I leave the residue of the estate not disposed of as hereinabove described to my mother".

Real property distributions are similarly classified as either specific devises, general devises, or residuary devises.

If a residuary disposition does not specify whether it is a bequest or devise then it will cover all remaining property, both real and personal.¹³

When a decedent leaves no will, the laws of the state stipulate how the property is to be distributed to any beneficiaries. The laws of intestate (without will) succession generally specify that distributions are determined in light of the various marital and blood relationships that existed between the decedent and his surviving relatives.

Many states distinguish between intestate distributions of real and personal property. The pattern of distribution of real property is determined by the law of descent, and personal property dispositions are determined by the laws of distribution. Persons receiving assets under either the laws of descent or the laws of distribution are known as heirs.¹⁴ Generally, surviving spouses have precedence over other heirs, and the process of determining appropriate shares of distribution can become very complex.

There are instances when a will exists but it does not

13. Simons and Karrenbrock, 742.

14. Simons and Karrenbrock, 741.

provide for distributions of all of the estate assets. This condition is referred to as partial intestacy, and the undistributed properties are disposed of according to the laws of descent and distribution.¹⁵

State laws often provide for curbs against abuses that can occur in a decedent's will. Thus, a mere reading of the will may not be sufficient to establish the appropriateness of the proposed distributions. For example, a will can not be used to disinherit a spouse. Most states specifically provide the surviving spouse protection under a right of election statute or an elective share statute. Typically these statutes enable the surviving spouse to make an election to take a specified percentage of the value of the decedent's estate, even if the decedent chose to leave no property to the surviving spouse under the terms of the will. Other examples include, mortmain statutes which prohibit excessive charitable bequests when the decedent is survived by a spouse, children, or other heirs, and statutes which invalidate will provisions that, by their nature, are illegal. The final arbiter as to the application of any of these provisions is the court.

It is important that the fiduciary identify and make a proper accounting for the potential distributions, whether by will or succession. For instance, any income earned, after a

15. Simons and Karrenbrock, 742.

decedents death, by an asset subject to a specific bequest or devise belongs to the beneficiary in who's favor the specific bequest or devise is executed. Also, a specific bequest or devise fails when the asset subject to the disposition no longer exists. Furthermore, all bequests and devises generally lapse if the heir predeceases the decedent. The assets revert to the residuary portion of the estate unless the heir was a close relative and is survived by children, in which case the children usually receive the property. These examples show how important it is to maintain an adequate information system to insure proper disposition of assets.

Another way in which distributions can be altered from their original intent is in the instance where satisfaction of the estate's debts makes it impossible to meet the bequests and devises specified in the will. This condition results in abatement and/or ademption.¹⁶ Abatement refers to a proportionate reduction of certain categories of bequests or devises, and ademption refers to the complete elimination of certain categories of bequests or devises. Unless the will terms specify differently, state laws usually call for the reduction or the complete elimination of bequests or devises, due to insufficient estate assets, by classification in the following order: first residuary, then general, and finally, demonstrative and specific.¹⁷

16. Wixon et al., 25.30.

State laws often provide for a lapse of a period of time at the discretion of the representative before distributions of estate properties can be made. If the property is not actually distributed at this time, it may be necessary to pay interest on the distributed interest. In some instances, an advance might be made of some individual bequest before the overall distribution, which results in the distributee being obligated to pay interest to the estate for the period of the prepayment.

Closing the Estate

During the administration of an estate one or more accountings (to be detailed later) are filed with the court to notify the court of those estate assets that have already been distributed as well as those claims of creditors that already have been filed and paid. The accounting also informs the court of any additional expenses incurred by the estate as a part of the probate process. The court will deal with title transfers required to properly distribute properties to the appropriate beneficiary prior to completion of probate. The fiduciary usually obtains written receipts from beneficiaries as evidence verifying actual receipt of the estate assets. Once all claims and debts have been satisfied, all taxes have been paid, and all property has been distributed, the estate may be closed. The court typi-

17. Simons and Karrenbrock, 742.

cally requires a final accounting or a report be filed. A petition to discharge the fiduciary is also filed with the court. The filing states that the estate is in a condition to be closed and all debts and expenses of the administration except closing expenses and statutory compensation to the representative and his attorney have been paid. If the court is satisfied with all the accountings, reports and petitions, it can then approve the discharge of the fiduciary. This usually constitutes the completion of the probate process. However, there are circumstances under which the estate could be re-opened. For example, if additional assets are discovered, any of the accountings are deemed to be incorrect, or fraud has been perpetrated upon the court by a party at interest to the estate.

Court Accountings

The discussion up to this point has centered on the legal process of administration of a decedents estate, but now the presentation will address the reports that are the product of that administration as viewed from a strictly legal prospective. Later, the discussion will cover the fiduciary accounting aspect of the fiduciary responsibility from the bookkeeping and more tradition financial accounting standpoint.

The fiduciary of the estate is required to report to the court and to other interested parties on the progress of the estate administration and distribution. The form and content of the report can vary. In cases of larger estates, reports

may be required at regular intervals during the estate administration, whereas estates of smaller size and duration, reports may be required once, when the estate administration has been completed and the representative is requesting a formal discharge and closure. Reports summarizing activities of the estate during its administration are known as intermediate accountings. Reports submitted upon completion of the estate fiduciary responsibility are referred to as a final accounting.¹⁸

The accounting, report and distribution of a probate estate can be the most interesting part of the entire probate proceedings as the fiduciary is forced to justify, rectify and reconcile all of the problems encountered during the administration of what might have initially appeared to be a simple estate probate. The technical format of the report is not clearly defined and can vary from court to court, and even between judges. Yet, there is a generally accepted overall format that has developed through convention and can be seen in the report examples found in the appendices of this paper. Appendix A and B represent examples of actual reports that were submitted to courts. The names and other specific identifying features of these reports have been removed to insure privacy of the parties involved. The report in appendix A is interesting in that all schedules are

18. Simons and Karrenbrock, 743.

manually generated, and the description column would seem to be a useful tool in establishing a computerized system; the description column represents the field that could be used to tie the court report with the general accounting and income tax reports to be discussed later. Appendix B is unique in that the report contains non-inventory assets that have been included in the report. For example, schedule A, page A-2, shows a summary of cash transferred by action of law due to title being held in joint tenancy (as presented earlier in this chapter), yet these items have been included in the accounting for informational purposes, as was suggested previously.

Appendix C and D contain report example formats provided by attorneys that were contacted during research of this paper. These formats are being presented here so that they can be compared to the actual report examples, above, to assist in establishing a general format that will represent the basis for developing a working model report that the system being research will generate. After examining the various examples of reports the general pattern of the report emerges as follows:

Prepare Statement (or Summary) of Account.

Record asset disposition (gains and losses) and
account transfers.

Record receipts of principle.

Record disbursements of principle.

Record distributions of principle to

beneficiaries.

Record income receipts.

Record income disbursed.

Record distributions of income to beneficiaries.

Compute remaining property on hand.

The pattern also includes the necessity to report individual transactions in the accounting report, for example, each receipt of income is documented. This is dissimilar to traditional accounting wherein the final report represents a summary of an account balance, where individual transactions are buried in journals.

The legal accounting report format, with its basic in and out concept, has lead many attorneys to feel that although they might always hire an accountant to prepare accountings for their business clients, a probate accounting does not require that type of expertise, it requires only a basic knowledge of how to add and subtract and a good record keeping system. They feel that the report and petition for distribution can be filed and approved with the help of the probate code, knowledge of the status of the beneficiaries, and a copy of the will, if there is one. But this point of view raises a potential issue that must be addressed; whether the legal report requires a formal accounting system base from which the report should be generated. Without a doubt, any system being proposed by this research will require output of a legal report acceptable to the court. But, the in-

tegrated nature of the proposal makes this potential issue unfounded. The model will be useful to all users, whether attorneys, accountants, or fiduciaries. To properly protect the fiduciary that may implement the model, it is imperative to utilize all facets of expertise, whether legal, accounting, or otherwise. Besides, the comment that all one needs is a "good record keeping system" seems to direct attention to the traditional double entry bookkeeping system. A proven system that has years of practical experience. The legal report should be viewed in terms of the overall project, with the important interface points, and not from the singularly narrow legal prospective as to the report process.

The legal view of the report generating process is still, nevertheless, absolutely critical in that an estate typically would not be able to close without such a report being accepted by the court. California Probate Code Section 922 requires the fiduciary to render a full and verified account and report within thirty days after the time to file or present claims against the estate has expired. This section also provides that the representative must render a final account and petition for settlement of his administration whenever there are sufficient funds under his control to satisfy all debts and the estate is in a proper condition to be closed. The requirement of the accounting within thirty days after the expiration of time to file claims is seldom enforced and is used more often for authority for one other than the representative to compel an accounting. An account-

ing may be compelled by the court at any time on its own motion or by any person interested in the estate or by a successor representative, and particularly in cases where an accounting has not been rendered within thirty days from the expiration of claims filing, and when no account has been rendered and there are sufficient funds to pay all debts and the estate is in a condition to be closed, or where the representative's powers have been revoked or he has become incompetent. Probate Code Section 927 provides that any person interested in the estate may object to the accounting. If a person entitled to contest the accounting does not do so, then that individual forfeits their right to appeal any order settling the account. There is no statutory authority for the waiver of the accounting but it is permitted on a case by case basis. The waiver applies to the detailed accounting if all persons at interest to the estate agree. The waiver removes the need to supply an itemized schedule that supports the Summary of Account. But the Summary of Account itself, with account activities during the administration of the estate, is still required. Immediately upon settlement of the accounting and upon proper notice, the court proceeds to distribute the residue of the estate amongst the heirs. In the Judgment of Final Distribution, the court must name each person entitled to a part of the estate and must specify which part each is entitled. The Judgment, when it becomes final, is conclusive as to the rights of heirs. In fact, once final, the Judgment supersedes the will and becomes the

conclusive determination as to the validity, meaning and effect of the will, and the rights of all parties to the estate.

Accounting Background

The accounting for a fiduciary relationship is quite different from that which is found in traditional financial accounting. The issues facing any development of a model for the accounting aspect of the fiduciary responsibility are varied, unique, and rather interesting. The questions raised include: what kind of bookkeeping system is appropriate what is the impact of traditional financial accountings Generally Accepted Accounting Principles (GAAP) on fiduciary accounting are there specific fundamentals of fiduciary accounting, in other words, does a GAAP exist for fiduciary accounting

Accounting Principles

Fiduciary accounting emphasizes the importance of the delegated authority concept inherent in the fiduciary responsibility relationship. The legal authority which gives rise to the fiduciary relationship does not define how the accounting system should be established.

No special type of bookkeeping system is prescribed by law, but the system should be designed to provide a complete record of all transactions in sufficient detail to provide the information necessary for the representative of the estate to account to the probate court, account to other parties at interest, prepare a proper estate tax return, and

prepare fiduciary returns.¹⁹ The accounts of the fiduciary, therefore, should reflect the measure of his accountability and the extent to which he has carried it out. Stated in other words, the accounts should provide a record of all the events effecting estate properties and the actions the fiduciary has taken with respect to each of those properties.²⁰

The emphasis on the fiduciaries accountability results in a need to rethink the fundamental accounting equation. The equation is usually associated with a commercial enterprise, where the accounting focuses on disclosing changes in assets, liabilities, and owners' equity.²¹ This contrasts with the fiduciary who is concerned with only the assets he takes control over and his accountability for them. Thus the accounting equation of the fiduciary is assets = accountability, rather than assets = liabilities + owners' equity.²² Although the fiduciary is not supposed to be concerned with the long-term management of the estate properties for the

19. Wixon et al., 25.33.

20. Meigs et al., 800.

21. Davidson, 44-2.

22. Meigs et al., 800.

beneficiaries, and the collection and distribution of income is also supposed to be incidental to the main function of the fiduciary, it is more often than not that the fiduciary finds it necessary to record a multitude of such transactions. This results from the generally slow process that probate typically becomes.

There are very apparent and unique characteristics of fiduciary accounting that make it different from any other, including:²³

Assets valuation basis: the estate valuation basis is current value, whereas commercial entities use historical (original) cost.

Accounting for principle and income varies: the classification of an individual item as principle or income depends upon either the will or state law. Thus a lack of consistency between individual estates can exist as to fundamental classifications, in contrast to the relative consistency of accounting for transactions of commercial entities.

The accounts of the estate do not include liabilities: the fiduciary is responsible for

23. Dan M. Guy et al., Estates and Trusts, Guide to Compilation and Review Engagements vol. 3, 7th ed. (Fort Worth: Practitioners Publishing Company, October 1985), 16-3.

assets, not liabilities. It is only when a claim against the estate is paid that the liability appears as a disbursement.

The accounting reports are intended for a limited number of users: the reports are usually merely part of the legal documents of the probate proceedings, and they are of concern only to the relatively few parties at interest to the estate. This contrasts with the commercial entities that frequently publish their financial reports.

This list of unique characteristics highlights the differences between fiduciary and conventional accounting. Yet, there is one particular area of concern that most accounting authorities agree upon, that while a single-entry bookkeeping system is possible, a double-entry system is more appropriate. It is a time tested method that provides a greater degree of protection for the fiduciary against accounting errors and therefore assists him in more accurately discharging his responsibilities.

Most fiduciary accounting authorities also agree that the maintenance of the following books are recommended for the typical estate: general journal, cash receipts journal, cash disbursement journal, general ledger, and inventory subsidiary ledger.²⁴

24. Bernard Barnett, Attorney's Handbook of Accounting,

Search for GAAP

The search for Generally Accepted Accounting Principles (GAAP) for fiduciary accounting by reference to conventional accounting GAAP is rather ironic, since conventional accounting principles are constantly being subjected to theoretical examination and criticism. But at least a large body of literature, research, and authoritative statements provides an extensive foundation from which to review conventional accounting standards.

The task of identifying GAAP for fiduciary accounting is much more difficult. The accounting profession's authoritative organization, the American Institute of Certified Public Accountants (AICPA), has not issued any pronouncements relative to fiduciary accounting. There are no AICPA Statements of Position addressing this field, nor have they published any Industry Audit or Accounting Guides dealing with fiduciary accounting.²⁵

This apparent lack of authority leads many accountants to believe that GAAP for fiduciary accounting does not exist. However, the mere absence of an official pronouncement does not necessarily mean that a sufficient body of conventions,

ed. Henry Sellin (New York: Matthew Bender, 1971), 14-2.

25. Dan M. Guy et al., 16-6.

rules, and procedures does not exist that can be recognized as GAAP. GAAP can also be based upon practices that are widely recognized as being generally accepted as they may represent the prevailing practices within a particular industry.²⁶

Thus, GAAP for fiduciary accounting is based upon the existence of such widely recognized practices and other authoritative sources, such as those which follow:²⁷

Common practice and the courts.

Governing instrument - the will.

Governing instrument - state law.

Committee on National Fiduciary Accounting
Standards.

Other literature

Common practice and the courts refers to the procedures and formats developed; especially by the legal community, from the years of practical application of the law to estate administration. It also recognizes the ultimate authority of the court to, in effect, establish fiduciary accounting GAAP by court orders effecting the method of record keeping, as well as, the content and form of the probate report. This source of GAAP is most likely the predominant force effecting

26. Dan M. Guy et al., 16-6.

27. Dan M. Guy et al., 16-6/16-8.

fiduciary accounting today as it has in the past. Numerous examples of this impact have already been presented in previous sections of this chapter.

The second source of fiduciary accounting principles is the decedent's will. A valid will actually takes precedence over all other potential sources of authority, at least with respect to the probate report. But, when they exist, the will typically does not address accounting issues but rather identifies what and to whom property is to be distributed. It is rather a unique circumstance when a will defines what should constitute receipts of principle as opposed to receipts of income. It is for this reason that common practice and state law usually are the determining factors in establishing report content and format.

The third source of accounting principles comes from the governing instrument when there is no will (or just as frequently when the will is silent as to accounting matters), namely, state law. State law requires certain accounting rules and conventions. This would be a complex task if each state had it's own unique statutes, but fortunately, most states have adopted the basic accounting conventions of the Uniform Principal and Income Act. In California, the law can be found in Section 16300 of the Administration Code, and it is entitled the Revised Uniform Principal and Income Act. The addition of "revised" in the title refers to changes that California adopted in the act that became operative July 1, 1987. The act, a copy of which can be found in Appendix E,

details how to account for various receipts and expenditures, as well as, delineating what transactions normally effect principal verses income.

The fourth source of authority is the Committee on National Fiduciary Accounting Standards. The National Fiduciary Accounting Standards Project Committee was formed in 1972 and was comprised of representatives from various interested organizations having interest in banking, law, and accounting. The committee issued its report in May 1980, entitled Uniform Fiduciary Accounting Principles and Model Account Formats. While the committee's findings are not legally binding or recognized as authoritative by such bodies as the AICPA, they do provide valuable guidance in preparing financial reports.²⁸

The committee defined their view of the basic objective of fiduciary accounting and six accounting principles. They believed that the fundamental objective of the accounting should be:²⁹

To provide essential and useful information to interested parties.

To reduce costs and distractions by simplicity in presentation.

28. Dan M. Guy et al., 16-7.

29. Dan M. Guy et al., 16-7.

To avoid impairment of relationship between
fiduciary and beneficiaries.

The committee developed, from the fundamental objectives
above, the following fiduciary accounting principles:³⁰

The accounts should be presented in a form that is
understandable by those not familiar with the
practices and terminology peculiar to estate
administration.

The accounting should contain a summary of its
purpose and content.

The accounting should contain sufficient
information pertaining to all significant
estate transactions.

The report assets should be stated at both current
and date of death values.

The report should separate gains and losses.

The report should indicate significant trans-
actions that do not affect the amount for
which the fiduciary is accountable.

The committee, attempting to bring consistency to
fiduciary accounting, unfortunately did not fully develop
what could be called GAAP for fiduciary accounting. But, if
nothing else they included in these reports a "model
executor's account" report format, which presents a very good

30. Dan M. Guy et al., 16-7/16-8.

example of a detailed report. The example, a copy of which is reproduced in Appendix F, represents a useful tool for developing a working model of a fiduciary report, especially when viewed relative to the other reports in Appendix A through D.

The final source of authority for establishing generally accepted fiduciary accounting principles is other literature. This represents the various articles, text books, and hand books that address fiduciary accounting. Unfortunately, the volume and extent of this material is relatively limited. There is little theoretical development, most presentations focus on describing the practical application of existing procedures.

Does all of the above constitute an adequate body of accounting knowledge which in some fashion represents GAAP for fiduciary accounting, some agree, some not. But ultimately the academic argument is not really relevant to the problem of developing a decision support system that must meet practical needs, not theoretical. The argument is really only pertinent to the accountant who may issue a court report and must attach a cover letter pursuant to Statement on Standards for Accounting and Review Services (SSARS) reporting requirements. This particular problem will not be addressed because it is peculiar to the accountant, and does not otherwise affect users of the fiduciary responsibility model.

Application of GAAP

Whether termed generally accepted fiduciary accounting

principles or widely recognized practices, certain basic accounting conventions have emerged in recent years:³¹

The assets under the fiduciary's control should be accounted for in accordance with the will or state law, especially with regard to principal and income allocation.

An asset is recognized only when legal title transfers, it is converted to cash, or other evidence of its existence is documented.

Liabilities and expenditures are recognized only when payment is made by cash or transfer of another asset (cash basis).

The primary financial statement is the "Summary of Account". It is supported by various subsidiary schedules. The format begins with assets on hand at the beginning of the period, indicates receipts and expenditures during the period, and ends with assets on hand at the end of the period.

Assets are stated in the summary of account at the decedents date of death value, or subsequent acquisition cost.

In estate accounting the length of the accounting period is not fixed, it varies depending upon the court. For pur-

31. Dan M. Guy et al., 16-9.

poses of court reporting, the accounting period is the length of time since the last report. Thus, the period usually depends upon the frequency of the need for intermediate and final reports. Typically though, the books of the estate are closed at least once a year to facilitate preparation of a fiduciary income tax return, as detailed in the succeeding chapter.

The fundamental fiduciary accounting equation, assets = ~~accountability~~, reflects the fiduciary's basic responsibility to collect assets, handle receipts and expenditures, and to make proper distributions to beneficiaries. This means the accounts that must be established should reflect a record of events involving estate properties and the fiduciaries actions with regard to those assets. This process is usually accomplished by maintaining records whereby:³²

Asset accounts are charged and Estate Principal (the accountability account) is created for assets in the possession of the fiduciary. The disposition of estate properties at a gain, subsequently discovered assets, and estate income are charged to individual asset accounts and in individual nominal accounts (indicating proper source of asset increase) are credited.

32. Simons and Karrenbrock, 744-745.

The disposition of estate properties at a loss, payment of debts and administration expenses and distributions to beneficiaries are credited to the appropriate asset account and individual nominal accounts (indicating the reason for the asset decrease) are debited. Nominal accounts are closed to Estate Principal at the close of the accounting period, and the Estate Principal account is eliminated when all assets have been distributed to the beneficiaries.

The bookkeeping entries necessary to maintain records of the detailed transactions that comprise the administration of an estate can be summarized as follows: (1) opening of estate books: debit individual asset accounts and credit Estate Principal account, values from inventory and appraisement, (2) subsequently discovered assets: for assets discovered after the initial inventory, debit individual asset account and credit Assets Discovered, value based on date of death value, (3) asset disposal: estate properties converted into cash (to pay debts, expenses, or facilitate distribution), cash is debited, the individual asset account is credited, and any gain or loss is posted to a nominal account Gain/Loss on Asset Disposal, (4) collection of estate income: income earned after date of death is recorded by debit to Cash and a credit to individual nominal account, (5) payment of expenses: estate expenses paid during administration are re-

corded by a credit to cash and a debit to the appropriate nominal account, (6) payment of decedents debts: payments of debt recorded by a credit to cash and a debit to a nominal account, Debts Paid, (7) collection of claims and asset transfers: collection of such items as receivables and mere asset to asset transfers are recorded by debits and offsetting credits to the individual asset accounts, (8) distribution of estate assets to beneficiaries: distributions to beneficiaries recorded by credit to individual asset distributed and a credit to a separate distribution account, (9) operation of a going business: the records of the business are maintained separately from the estate's with controlling account in the estate representing the investment in the business at the date of death value. After decedent's death, business books are closed, liabilities removed, and reopened at appraised values. Continuing records are maintained in the usual fashion, (10) closing estate books: the books are closed at the end of each accounting period by transferring the nominal account balances to Estate Principal.

After the closing, the Estate Principal should equal the assets on hand. When all of the estate assets have been distributed, the transfer of nominal accounts will eliminate Estate Principal. The closing of the books and elimination of the Estate Principal account upon final distribution means that the fundamental accounting equation is gone. Thus, assets = 0 and accountability = 0, which is symbolic of the release of the fiduciary, by the court, from his respon-

sibility to be accountable in a fiduciary relationship.

Conclusion

This chapter has presented a detailed overview of the legal and accounting aspects of the administration of a decedent's estate. From this detail, the picture of what the application program (comprising the tier one level of the model proposal) will look like begins to emerge. The model report format, examples of actual forms submitted to the courts and the topical discussion, shows a general format, basic terminology, and accounting conventions common to all estates that make the accounting and legal report requirements feasible. This is true especially of California since that is the state upon which this presentation is being centered. Yet, despite the variety of state laws, a model developed will have general application to all states, if nothing else, at least as a worksheet that aids users in reporting in the specific format that an individual state may require. This is because the accounting conventions are common enough, even if the actual report formats differ.

The secondary issue relates to the tier two development of the model; the expansion of the decision support system into an expert system. This chapter has, through its presentation, identified those areas of possible development of the expert system for problem solving. An expert system could address such concepts as: distinguishing between probatable and non-probatable assets; determining effect of will provisions on estate accounting; defining the effects of the

Revised Uniform Principal and Income Act on estate transactions; assist in identifying and classifying estate assets; and the possible expansion to include assistance in estate asset valuation (useful for federal estate tax computation, as well as for inventory and appraisement purposes). Finally, the specific concerns of the legal and accounting aspects of the fiduciary responsibility, relative to the model development, are further addressed in chapter 4 of this paper.

CHAPTER 3

Fiduciary Responsibility: Income Tax

Fiduciary Income Tax

The presentation in Chapter 2 focused on the legal and accounting aspects of a decedent's estate, now the income tax implications will be presented. It should first be made clear specifically what kind of taxation is being addressed. Upon the death of an individual, many tax consequences arise. First, The fiduciary is responsible for filing a personal income tax return on behalf of the decedent. This final income tax return is typically for the period beginning with the first day of the calendar year and ends at the date of death. Any income received or deduction generated during this period of time are reported on this return. The second tax consequence relates to the estate and inheritance taxes. The federal estate tax (reported on federal form 706) is levied on the descendants ability to transfer property at death, whereby the tax is computed on the value of the net assets transferred. State law taxes the beneficiaries entitlement to receive estate properties, this is accomplished by an inheritance tax. Finally, the decedent's estate must pay income tax on the income received during the period beginning with the date of death and ending with the closure of the estate administration. This is the tax which is to be integrated with the legal and accounting aspects of the overall fiduciary responsibility model.

Overview of Subchapter J

The income taxation rules for estates (and trusts) are contained in Subchapter J of the Internal Revenue Code, in sections 641 through 692 (see Appendix H). Subchapter J is rather interesting and unique in its application. This uniqueness results from the fact that estate fiduciary taxation draws its foundation from many other areas of taxation. For example, generally the definition of gross income and deductible expenditures is similar to individual taxation, the conduit principle of passing taxability to beneficiaries is similar to partnership taxation, and finally, the fact that it can be a separate tax paying entity as well as a conduit for taxability is similar to S corporation taxation principles.

This theoretical complexity would seem to naturally lead one to believe that fiduciary income tax return preparation is just as complex. As was noted early on in the presentation in this paper, there is a fear associated with this area of taxation. This fear would seem to be due to the lack of attention paid to this topic by practitioners when choosing the areas of taxation to study through continuing education. This, of course, is more than likely due to the infrequent need by most practitioners for this expertise, unless of course they specialize in handling decedents estates. But, as the overall age of this country continues to increase, the need for such expertise will most certainly increase. This need will be met by more experts, or by general practic-

tioners with access to expert systems assistance.

Fortunately, the basic approach to estate transaction as prescribed in Subchapter J of the code can be summarized as a process which involves the placement of tax responsibility rather than the determination of total taxability. The basic concern is not necessarily how much will be taxed but rather to whom will it be taxed. This approach can be summarized as follows:³³

An estate earns or receives income and incurs and
and pays expenses.

It makes distributions to beneficiaries as
required by the governing instrument (will or
state law).

Total taxable income is subjected to income
taxation: taxed to the estate to the extent
the estate retains it, and to the beneficiary
to the extent it is distributed or required to
be distributed to the beneficiary.

This approach results in the following rules, unique to
fiduciary taxation:³⁴

33. Hyman Gorenberg, Income Taxation of Estates and Trusts
(New York: American Institute of Certified Public Accountants,
1987), 1-3.

34. Gorenberg, 1-3/1-4.

The taxable income and deductions of the estate are computed in a manner similar to that used for individuals; though several important exceptions do exist.

The estate is entitled to a deduction from taxable income, for income distributed to beneficiaries, (distribution deduction).

The taxable income retained by the estate is taxed to the estate.

The beneficiaries report their distribution and pay income tax on it.

This total taxable income is always taxed, but the beneficiaries are never taxed on more than their share of the distributable net income of the estate.

Estate Accounting Income

A close examination of the various sections contained in Subchapter J of the code reveals that a number of references are made to the income of the entity. These references are made to "income" without the usual modifier found through the code, such as, "taxable" income or "gross" income. This is because Internal Revenue Code Section 643 (b) defines income, wherever it appears in the code without a modifier, as the amount of estate income for the taxable year as determined under the terms of the will or applicable state law. It is already apparent from chapter 2 that if the will is silent as to the proper allocation to income or principal, then the Revised Uniform Principal and Income Act will automatically

make such an allocation.

This computation of estate accounting income, based upon the allocations as determined by the governing instrument, does not determine the treatment of items of income and expenditure for taxable income purposes.³⁵ Estate accounting income is the amount that the income beneficiary, by law, is eligible to receive from the estate. This definition of estate accounting income is critical to determining the amounts deductible by the estate and thus the amounts taxable to the beneficiaries.

The significance of this definition, in practical terms, is that the distribution deduction allowed by the decedent's estate (which ultimately determines to whom taxability will fall) is the sum of: (1) any amount of income (estate accounting income as defined by the governing instrument) for the taxable year that is required to be distributed currently,³⁶ and (2) any other amounts, whether income or principal, properly paid or credited or required to be distributed for that taxable year,³⁷ except amounts

35. William H. Hoffman ed., 1985 Annual Edition West's Federal Taxation: Corporations, Partnerships, Estates, and Trusts (St. Paul: West Publishing, 1985), 671.

36. Internal Revenue Code of 1986, Section 661(a)(1), as amended through P.L. 99-514 October 22, 1986.

representing; specific bequests,³⁸ payments to charity,³⁹ and real property passing directly to heirs.⁴⁰ In addition, this computed distribution is deductible only to the extent that it does not exceed the Distributable Net Income (DNI) of the estate for the taxable year. DNI is defined as estate taxable income before the distribution deduction, modified as follows:⁴¹ Add back estate personal exemption deduction, add back net tax-exempt income, add back the deduction for estate tax attributable to income in respect of a decedent, and finally, remove net capital gains. Therefore, the distribution deduction allowed to the estate (and thus amount taxable to the beneficiary) is the lessor of required and discretionary distributions to beneficiaries (not including stated exceptions) or distributable net income.

37. Code Sec. 661(a)(2).

38. Code Sec. 663(a)(1).

39. Code Secs. 642(c) and 663(a)(2).

40. Internal Revenue Service Regulation 1.661(a)-2(e).

41. Code Sec. 643(a).

Fiduciary Income Tax Return

The fiduciary income tax transactions are reported on federal form 1041 and its associated schedules (see Appendix G). A close examination of form 1041, especially the first page, provides one with a valuable outline of the computational requirements of an estate fiduciary. The first computational step involves income determination, which is comprised of the following: dividends, interest, income or losses from partnership, other estates or other trusts, net rent and royalty income or loss, net business and farm income or loss, capital gains or losses, ordinary gains or losses, and other income. From the total income, the following deductions are taken: interest, fiduciary fees, charitable contributions, professional fees, and other deductions including taxes. The resulting subtotal is called adjusted total income or loss, and from this subtotal is subtracted the following additional deductions: the income distribution deduction (as discussed in the previous section), the estate tax deduction (estate tax paid on income in respect of a decedent), and finally the personal exemption allowed each estate in the amount of \$600.00. The resulting amount is called the taxable income of the fiduciary; this is the amount of income attributed to the fiduciary, as the amount attributed to any beneficiaries has been subtracted above in the income distribution deduction. The final step is the computation of the estate tax and subtraction of the statutory credits allowed against the tax.

The fiduciary income tax return also has various schedules that are frequently prepared and attached with the standard form 1041, page 1. For example, the second page of the form contains Schedule A which is used to compute the estates charitable deduction and Schedule B, wherein the income distribution deduction is computed. An individual Schedule K-1 (form 1041) is attached to the return for each beneficiary; so each beneficiary, if applicable, will be informed of his share of reportable income, deductions, or credits, that have been passed through to him. Schedule D (form 1041) is used to report transactions giving rise to capital gains and losses, and allocates such gain or loss between the fiduciary and the beneficiary.

Fiduciary Filing Requirements

An income tax return must be filed for an estate when the gross income of the estate for the taxable year is \$600.00 or more, or when any beneficiary of the estate is a nonresident alien.⁴² The return filed by the fiduciary, on behalf of the estate, is due on or before the 15th day of the fourth month following the close of the estate's taxable year. The taxable year of the estate begins at the moment of the decedent's death and ends on the last day of the month selected by the fiduciary, provided it does not exceed 12 months.⁴³

42. Code Sec. 6012(a).

A fiduciary continues to file annual returns during the period of the estate administration.⁴⁴ The period of estate administration begins with the decedent's death and continues through the time actually required by the fiduciary to perform the usual duties of administration, such as the collection of assets, payments of debts, and distribution of estate properties to the beneficiaries, whether the period required is longer or shorter than the period specified by applicable state law for the settlement of an estate.⁴⁵ Thus, for tax purposes the administration period ends when the estate is in a condition to be closed.⁴⁶ The estate will be considered closed for federal income tax purposes after the expiration of a reasonable period of time in which to have performed the duties of administration. In addition, an estate is con-

43. U.S. Department of the Treasury, Tax Information for Survivors, Executors, and Administrators, Internal Revenue Service Publication, no. 559 (Washington: GPO, November 1986), 9-10.

44. Code Sec. 641(a)(3).

45. Reg. 1.641(b)-3(a).

46. Caratan, (1950) 14 TC 934; Herbert, (1956) 25 TC 807(A).

sidered closed when all the estate assets have been distributed except for funds retained to pay contingent debts or expenses.⁴⁷

The accounting period of the estate is chosen when the first income tax return is filed by the fiduciary. An estate may use any of the tax accounting methods available to individuals; in the majority of cases the cash method is used. Once the accounting period or method has been established, the fiduciary may not change it without permission of the Internal Revenue Service.⁴⁸

For bookkeeping purposes, the books of the estate are opened upon the decedent's death; they are initially closed after the first year, which could be less than 12 months in length. Then the books are closed annually throughout the estate administration, until the estate is closed for tax purposes, which again might be less than 12 months in length. The final income tax return for the estate must be filed by the 15th day of the fourth full month following the date the estate is closed.

Estate Gross Income

The gross income of an estate is determined in the same

47. Reg. 1.641(b)-3(a): Internal Revenue Service Revenue Ruling 73-397, 1973-2 Cum. Bull. 211.

48. Internal Revenue Service Publication, no. 559, 10.

manner as that of an individual. The general difference between estate and individual taxation is due to the need to divide the estate income tax burden between the estate and fiduciaries, not in a difference in defining gross income. Gross income to the estate is basically the same as to an individual: dividends, interest, rents, royalties, capital and ordinary gains, etc. Code Section 641 (a) provides that gross income includes the following:

Income accumulated or held for future distribution under terms of the will.

Income which is to be distributed currently by the fiduciary to the beneficiaries.

Income received by estates of deceased persons during the period of administration or settlement of the estate.

Income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated.

Although all the foregoing items may represent gross income to the estate, they do not necessarily represent taxable income to the estate. The income specified in the first item is taxed to the estate; all income specified in the second item is deductible by the fiduciary and is taxed to the beneficiary, whether distributed or not; the income specified and the third and fourth items may be eventually taxed to the fiduciary or to the beneficiary, depending upon the amounts which are properly paid or credited to the beneficiaries.

Because items of income received during the administration which are included in gross income are determined in the same way as an individual, it follows that tax exempt interest received by an estate is excluded. The estate's gross income includes only income items belonging to the estate, not items belonging to the heirs and beneficiaries. Once an asset that generates taxable income is distributed, it becomes the responsibility of the distributee to report any subsequent income.⁴⁹ If the governing instrument (the will or state law) specifically attributes an item of income to the estate, the fiduciary must report it even if the beneficiary is in actual possession of the income, unless of course it had actually been distributed by the estate. Conversely, if the governing instrument attributes the income item to the beneficiary, he must report it, even though it may not have been distributed to him.⁵⁰

There are many items of income which are unique and/or require special attention, some of those items include the following:

An estate should segregate income the decedent was entitled to receive at his death, but was not yet paid, and therefore not includable on his

49. Brown, (1948) 11 TC 744, affd. (CA5) 180 F2d 946.

50. Donnelly, (1934) 31 BTA 577(A).

final personal income tax return. These amounts are includable in taxable income of the fiduciary, but a deduction is allowed for any estate tax paid as a result of these items being included on the estate tax return as well. These items include accrued interest and rents, pension benefits, and unpaid wages.⁵¹

Income from real property subject to probate court administration is includable in the fiduciary return during the period of administration.⁵²

Income from property passing directly to beneficiaries (i.e. property held in joint tenancy with right of survivorship) is reportable by the individual beneficiaries.⁵³ In addition, any gains or losses on disposition of such properties belongs to the beneficiaries; unless such disposition is due to a court order necessitated by insufficient estate properties to meet decedent debts. In

51. Code Sec. 691.

52. Rev. Rul. 57-133, 1957-1 Cum. Bull. 200.

53. Peterson, (1961) 35 TC 962(A).

such a case the sale is divided between the estate and beneficiary based upon the proportional amount of proceeds received by each.⁵⁴

Income generated by properties that have been specifically bequested follow the general rule that the governing instrument determines to whom taxability is assigned.⁵⁵

Interest income generated on Series E or EE U.S. savings bonds redeemed by the estate (from a cash basis decedent) is reportable either by the decedent during his lifetime, if he so elects, or if he did not so elect, then the fiduciary has the option to report it on either the decedent's final personal income tax return or on the fiduciary income tax return.⁵⁶

Income is generated to the estate when the fiduciary of the estate makes collection on

54. Rev. Rul. 59-375, 1959-2 Cum. Bull. 161.

55. Woolley v. Malley, (1929, CA1) 30 F2d 73.

56. Rev. Rul. 68-145, 1968-1 Cum. Bull. 203; Internal Revenue Service Letter Ruling 8217231.

claims the estate has against others to the extent the proceeds received exceed the tax basis in the claims (the basis being the current value at the date of death). An example might be a note, thought worthless at the decedent's death, and thus valued at zero, is subsequently collected.⁵⁷

Income may result from the discharge of indebtedness rule of Code Section 61 (a) (12) when a debt of the decedent is canceled or voided because a creditor failed to file a proper claim against the estate. Such income may be deemed to be a distribution of such amount to the beneficiaries.

Income from a partnership interest of the decedent is handled in the same manner as the general rule, in other words, according to the governing instrument specifying ownership.⁵⁸

Income resulting from property classified as community property (i.e. in California) is taxable one half to the fiduciary and one

57. Est. Herbert v. Com., 139 F2d 756; Est. Zober (1957) 28 TC 885.

58. Caldwell v. U.S., (1939, CA7) 102 F2d 607.

half to the surviving spouse, until distributed upon completion of the estate administration, at which time taxability belongs solely to the surviving spouse.⁵⁹

Capital gains and losses, even though the 60% capital gains deduction has recently been appealed,⁶⁰ are still taken into account in computing taxable income just as if the estate were an individual. The determination of gross income for estate income tax purposes makes no distinction between capital gains or losses allocated to principal or income as in the case for estate accounting purposes. The estate gross income also includes gains from the sales of assets, which the fiduciary has legal control over, even if the purpose is to pay creditors, expenses of the administration, or make distributions to beneficiaries and heirs. The character of the gain or loss, ordinary or capital, is dependent upon the nature of the asset in the hands of the fiduciary, just as it is for an individual. Generally, in computing the amount of gain or loss, the estate basis in the property is the fair market value at the date of death, or at the alternate valuation date, if elected. For property purchased by the estate

59. Rev. Rul. 55-726, 1955-2 Cum Bull. 24.

60. By the Tax Reform Act of 1986, P.L. 99-514
October 22, 1986.

during the administration, the basis usually is its cost of acquisition.

In general, an estate does not recognize a gain or loss upon its distribution of property to its beneficiaries. However, the fiduciary has an option, he may elect to recognize a gain or loss on any distribution of property, except cash and specific bequests, as if the property had been sold to the distributee for its fair market value; where fair market value is determined at the time of distribution. The Tax Reform Act of 1986 made this election applicable to all distributions in a taxable year, not on an individual basis.⁶¹ The beneficiary receiving the property distribution obtains a basis in the property adjusted by the gain or loss. In addition, the estate may recognize a gain or loss if the distribution is made in satisfaction of a beneficiary's right to receive a specific dollar amount or in specific property other than that distributed; the gain or loss is the difference between the specified dollar amount, or the fair market value of the specific property at the date of distribution, and the estates basis in the property distributed. The estate also realizes a gain or loss on the distribution of property in satisfaction on any claims against the estate, measured by the difference between the amount of the claim and the estates basis in the property.

61. Code Sec. 643(e).

Estate Deductions and Credits

Whereas the taxable income of an estate is computed in a manner similar to that of an individual, so it follows that the deductions and credits are also basically the same as for an individual. However, there are some unique differences between fiduciary and personal taxation, including: the distribution deduction, the treatment of payments to charity, the deduction for personal exemption, and in the tax rates themselves.

The important aspects of the fiduciary's deductions and credits can be summarized as follows:

The personal exemption amount that can be deducted by an estate is \$600.00 (for an individual it is \$1900.00 for 1987).⁶²

The tax credits available to an individual (i.e. investment tax, foreign tax, targeted jobs tax credits, etc.) are generally the same for an estate. The credit is apportioned between the fiduciary and the beneficiary on the same basis as income is allocated to each.

The deductability of business and non-business expenses by an estate is substantially the same as for an individual. Code Section 162 allows a deduction for ordinary and necessary

62. Code Sec. 642(b).

expenses paid or incurred in carrying on a trade or business. Code Section 212 allows a deduction for expenses paid or incurred for the production or collection of income; for the management, conservation, or maintenance of property; and in connection with the determination, collection, or refund of any tax. Reasonable estate administration expenses including fiduciary, legal and accounting fees qualify as deductions under the latter code section.

Code Section 212 expenses allocable to the production or collection of tax-exempt income are not deductible. The disallowed deduction is determined by multiplying the total potential Code Section 212 expenses by the ratio of the exempt income components of the estate accounting income to all the income (without regards to expense items allocable to income) components to the estate accounting income.

An estate is generally allowed the same deduction, under Code Section 164, for taxes as an individual is.

An estate is generally allowed the same deduction, under Code Section 163, for interest as an individual is. The Tax Reform Act of 1986

has made substantial changes to the determination of deductible interest, specifically: qualified residence interest is generally fully deductible; investment interest is generally deductible to the extent of investment income; interest connected with passive activities is generally deductible to the extent of passive activity income; interest connected with a trade or business is fully deductible; and all other interest is generally not deductible. These new rules are subject to a four year phase in period, and disallowed investment and passive activity interest can be carried over to future years.⁶³

Estates are entitled to a deduction for casualty or theft losses,⁶⁴ capital losses,⁶⁵ and net

63. U.S. Department of the Treasury, Explanation of the Tax Reform Act of 1986 for Individuals, Internal Revenue Service Publication, no. 920 (Washington: n.p., August 1987), 25,35-36.

64. Code Sec. 641(b).

65. Jones v. Whittington, (1952, CA10) 194 F2d 812.

operating losses,⁶⁶ occurring during the administration.

Depreciation, depletion, and amortization deductions are generally apportioned between the fiduciary and income beneficiary based upon the income of the estate allocable to each.⁶⁷

Generally, administration expenses and losses, which could be deducted for estate tax or income tax purposes, can only be deducted for one or the other. The exception is deductions relating to income reported for both purposes, namely, income in respect of a decedent.⁶⁸

Generally, for individuals, the Tax Reform Act of 1986 allows a deduction, in computing taxable income, for miscellaneous deductions in excess of 2% of adjusted gross income. However, a special provision covers estate administration expenses, whereby those

66. Code Sec. 642(d).

67. Code Secs. 642(e) and 642(f).

68. Code Sec. 642 (g).

administration expenses incurred simply because the property is held in an estate are not subject to the 2% floor, and those administration expenses that would have been incurred regardless of the estate are subject to the 2% floor. There is little doubt that fiduciary, legal and accounting fees are required as a result of the ~~property~~ property being in an estate, and therefore those subject to the 2% computation should be rather limited.⁶⁹

The various items presented above represent a sample of the major deductions and credits available to an estate. There are two other categories, the estate tax deduction and charitable deduction, which require further discussion.

An estate, or an income beneficiary, taxed on income in respect of a decedent is entitled to a deduction for any federal estate tax on the decedent's estate, or personal return of income beneficiary, that is attributable to such income. The purpose of this provision is to prevent double taxation, where income in respect of a decedent is reportable for both estate tax and income tax purposes. Thus, the

69. David S. Rhine, "The Estate and Trust Rules of the Tax Reform Act of 1986," The Tax Advisor, May 1987: 306-307.

fiduciary income tax return makes provision for a deduction of estate taxes paid on income reported on both returns. Income in respect of a decedent generally refers to those items of income to which a decedent was entitled to but which were not includable in his final return under his method of accounting (typically cash-basis). Income in respect of a decedent includes: all accrued income of a cash-basis decedent; income accrued solely by reason of death of an accrual basis decedent; and income to which the decedent had a contingent claim at his death. It can include such specific items as: accounts receivable of a cash-basis decedent; compensation for services of a cash-basis employee received after death; and gain realized from the sale of property completed before the decedent's death but the sale proceeds are received by the estate. It should be remembered that deductions for business, and non-business expenses, interest, and taxes, to the extent that they are not allowable in the decedent's final return are available to the estate, provided the estate is liable for the obligation to which the deduction relates. The deduction allowed to the estate for federal estate tax attributed to income in respect of a decedent is computed as follows:

First, add up all items of income in respect of the decedent includable in the income of the estate and/or beneficiaries, and subtract from this amount the total deductions in respect of the decedent allowed to be taken by the estate

and or beneficiaries. This difference is called the net value.

Second, deduct from the federal estate tax (after credits) actually imposed upon the estate the federal estate tax (after credits) that would have been imposed if the net value above had not been included in the gross estate. The difference represents the estate tax deduction attributable to the net value of the income in respect of the decedent.

Finally, this deduction is allocated between the estate and income beneficiaries based upon the ratio of the gross estate value of the right to the income reported by the recipient to the total gross estate value of all items of income and respect of the decedent.⁷⁰

There is another specific deduction that requires further discussion, and that is the charitable contribution deduction. An estate is permitted an unlimited deduction for any part of its gross income that, pursuant to the terms of the will, is paid to an organization specified in Code Section 170 (c)(2) (religious, charitable, scientific, literary, or educational organization). The will has been specified, rather than the governing instrument, because state law does

70. Code Sec. 691.

not usually make provision for charitable contributions. An estate is also entitled to deduct any part of its gross income which by the terms of the will are either permanently set aside for qualified charitable purposes or which is discretionary with the fiduciary. While the deduction is termed unlimited, there actually are certain limitations to the deduction. First, no deduction is allowed for amounts paid out of principal. Second, no deduction is allowed for any amounts attributable to tax exempt income. The ratio of the tax exempt portion of gross income to the total gross income (including tax exempt) is multiplied by the potential charitable deduction, to arrive at the amount that is non-deductible. Finally, beneficiaries in the first tier of the calculation of the distribution deduction can limit the amount of the charity deduction.⁷¹

Taxation of Beneficiaries

It has already been noted that the basic concept in the fiduciary income tax area is that total taxable income must be subjected to tax. The important concern that confronts an estate in preparation of the fiduciary income tax return is to whom will taxability ultimately rest, the estate or the income beneficiaries. This allocation problem is solved by use of the distribution deduction, introduced earlier in this chapter, whereby distributions to beneficiaries can trigger

71. Code Sec. 642.

the shifting of taxation to the beneficiary from the estate. If the estate does not make, and is not required to make, any distributions, nothing further need be done since the income is subject to taxation where it remained, in the estate. However, if the fiduciary distributes or is required to distribute income, the estate will be taxed only on the income it retains, while the beneficiary will be taxed on the income distributed or required to be distributed. This is accomplished by the distribution deduction. Generally a distribution triggers tax to a beneficiary, usually any distribution causes a transfer of taxability, except for payments to charity and specific bequests. The measure of the distribution is the cash, or the tax basis of the property to the fiduciary.

The distribution deduction is the lessor of the distribution or the estate's distributable net income (DNI). The use of DNI as a limiting factor, protects against the possibility of distributions in excess of actual estate taxable income causing greater taxability to the beneficiaries than actually exists within the estate. The actual computation of the distribution deduction has already been presented, so it will not be necessary to review the mechanics of its computation. What will be emphasized here is the point that regardless of whether the distribution deduction is based on the actual or required distribution, or has been limited by DNI, the resulting income attributed to the income beneficiaries retains its character. The charac-

ter of reportable income is the same as its character in the hands of the estate. The best illustration of this can be found by examining the Schedule K-1 (form 1041) on which the estate reports the beneficiaries share of income, deductions, credits, etc. for the taxable year. Thus a distribution of property, not constituting a specific bequest, to a beneficiary causes that beneficiary to report his probate share of the components of estate taxable income and deductions, such as taxable interest, tax-exempt interest, dividends, capital gains and losses, other capital gains and losses, depreciation and depletion, amortization, and even his share of the estate tax deduction attributable to income in respect of the decedent.

The law permits a decedent to allocate, by will, different classes of income to different beneficiaries. In absence of any allocation through the governing instrument, the amounts distributed are treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income of the estate.⁷² Charitable deductions are allocated among the classes of income entering into the computation of the estate income, and other deductions that enter into the computation of DNI are allocated among the items of income in the following manner:

72. William H. Hoffman ed., 692.

If a charitable deduction is involved, it is first ratably apportioned among each class of income entering into the computation of the distribution deduction including tax-exempt income, unless the governing instrument specifies otherwise.⁷³

Deductions directly distributable to one class of income are allocated to that class.

Deductions that are not directly attributable to a specific class of income are allocated to any item of income included in the computation of the distribution deduction, at the discretion of the fiduciary, but must allocate a non-deductible portion to non-taxable income.⁷⁴

To the extent that any deductions which are directly attributable to a class of income exceed that class of income, they may be allocated to any other class of income.

The capital loss and net operating loss carry-overs available to an estate may not be distributed to any beneficiary during the administration of the estate. But

73. Rev. Rul. 1.662(b)-(c).

74. Reg. 1.652(b).

upon termination of the estate any remaining carry-overs are allowed to the beneficiaries succeeding to the properties of the estate. If the deductions (other than the personal exemption and charitable contribution) of an estate for its final taxable year exceed gross income, the excess is allowed as a deduction to the beneficiaries for the taxable year in which the estate terminates.

When properties are distributed in kind to beneficiaries Code Section 6039A requires that the beneficiaries be notified of the tax basis of the items distributed. The code does not specify the form in which this information should be supplied to the beneficiaries, thus either the legal and accounting, or income tax reports should contain this data.

Recent Changes in Tax Law

Estates are subject to an alternative minimum tax which must be paid instead of the regular income tax if it is greater. The estate's alternative minimum tax is computed generally in the same way as an individual. The Tax Reform Act of 1986 broadened and strengthened the minimum tax provisions for individuals, and for estates as well. The alternative minimum tax is equal to 21% of the excess of an estate's alternative minimum taxable income over its exemption amount. This exemption amount, \$20,000.00 for an estate, is phased out beginning when the estate alternative minimum tax income exceeds \$75,000.00. The alternative minimum tax income is taxable income computed with certain adjustments and increased by the amount of the tax preference items. Tax

preference items, which must be allocated between the estate and income beneficiaries, include, an estate's alternative tax itemized deduction including the deduction for charity and the distribution deduction, accelerated depreciation on new property, passive activity losses, and many others.⁷⁵

The new law also formalized into the tax law the concept of passive activity losses (for activities in which the estate does not materially participate). Losses that are generated from passive activities can only be used to offset income from passive activities. Disallowed deductions are carried forward, and special phase in rules apply to investments acquired before October 26, 1986. Therefore, passive income or losses that pass through to income beneficiaries must be segregated as to the date of original investment. Exceptions apply to certain rental activities and working interests in oil and gas property.⁷⁶ Another distinction is made for what is called portfolio income, representing interest, dividends, annuities, or royalties not derived in the ordinary course of trade or business. The Schedule K-1 (form 1041) for 1987 refers to other portfolio income because dividends and interest are already segregated on the form. There are many more detailed aspects of these and other

75. Internal Revenue Service Publication, no. 920, 41-42.

76. Internal Revenue Service Publication, no. 920, 26.

changes made by the Tax Reform Act of 1986, but time constraints do not allow for a more detailed discussion of them at this point. Besides, many of these provisions will require many years of application, and the development of explanatory regulations, before they are completely understood.

Conclusion

This chapter has presented a detailed overview of the income tax aspect of the administration of a decedent's estate. It defines the major components of a fiduciary income tax return, namely what comprises gross income, the various deductions available, and how taxability can be passed to income beneficiaries. This detail allows for the development of a model, representing the logical flow of transactions and the mathematical computations necessary to properly administer the fiduciary's responsibility to file an income tax return for the estate. The resulting decision support system represents one half of the tier one modular development, whereas the legal and accounting aspects presented in chapter 2 represent the other half. With each separate component documented, especially when presented in pictorial form, such as a flow chart, it is then possible to integrate the two aspects. For example, complete integration would require that when income is received into the legal and accounting model, the nature of its character, taxable or tax-exempt, should be established.

Whereas the development of the tier one portion of the model requires a close integration between the legal and ac-

counting, and tax components, the expansion into an expert system does not require such detailed information. This is because the decision making involved by an expert system with regards to the income tax consequences of an estate are, more or less, independent of the legal and accounting aspects. This is not to say that it is not important or useful, but merely the level of integration is less than that applicable to the decision support system tier of the model. The issues that could be addressed by an expert system includes: the determination of the proper interpretation of the governing instrument for purposes of the charitable deduction and deductions allocated to distributable net income; the proper definition of the items of income, deduction, including income and deductions in respect of a decedent; and in properly defining distributions, such as specific bequests verses currently deductible distributions. More specific systems considerations will be presented in the final chapters.

CHAPTER 4

Fiduciary Responsibility: System Considerations

Introduction

In this chapter the presentation will focus on the system considerations of the fiduciary responsibility model. In chapters 2 and 3, the detailed aspects of the different segments of that model were identified; the legal, accounting, and income tax consequences. Now the paper will attempt to summarize these segments into a manageable form, identify the interface points, and consider the appropriate form and content of the model, while noting constraints and limitations. This analysis will take the form of the two tier modular approach presented earlier in the text. The research presented lends itself well to the development of the tier one level of the overall model, a decision support system, because the variables are quite manageable. In addition, the research identifies many of the possible avenues of expansion for the tier two level of the model, namely the integration of the system to include elements of an expert system. But further research will be necessary to actually carry out such an extensive task. The presentation will address the issues of the expert system in the final chapter of this paper.

Systems Definition

The logical starting point for any discussion of systems considerations would be the defining of what a system is. A

system is a set of related parts or components that are working together to achieve some common goal, objective or purpose.

Over the last twenty years, the concept of systems has evolved into quite literally a new discipline of study in business theory and practice. The need for information analysis has increased due to the ever increasing changes in complexity of business matters, the social environment, and also in the technology associated with information processing. The result has been a shift in defining a system in terms of what it is towards what it does.⁷⁷

Certainly today most systems considerations revolve around some form of computer technology. The emphasis now centers on the various levels of management decision making within a business organization, and the differing levels of decision making assistance offered by the computer technology. Typically, those levels are defined in terms of operational and decision support levels of informational processing.

The operational support systems are concerned more with day to day operations of the lower level manager, while the decision support system is more concerned with those decisions that extend beyond the routine operations.⁷⁸

77. John F. Nash and Martin B. Roberts, Accounting Information Systems (New York: MacMillian, 1984), 4-5.

The computer software that supports both these, and other support systems is becoming more complex and specialized.⁷⁹ The software discussed is typically divided into two general categories, system software and application software. System software usually involves how the hardware will operate, and is most often provided by the manufacturer of the hardware, and usually composed of the operating systems software and the utility functions software. Application programs, on the other hand, are associated with processing of data into information to be utilized in the decision making process. The programs can be vary specific, such as calculating loan interest amortization, or general, such as a spread sheet or a database manager.

The typical business system is comprised of various application software packages serving the various needs of an entity for information and data processing.⁸⁰ The basic categories of application program uses includes: file maintenance, report generation, information retrieval, and

78. Joseph W. Wilkinson, Accounting and Information Systems (New York: John Wiley, 1982), 486-487.

79. Wilkinson, 268.

80. Nash and Roberts, 225.

problem solving.⁸¹

The model being presented in this report is multileveled and therefore could be difficult to categorize. There is no question that the tier one level purposed, once programmed, would represent an application software program. But would it be utilized as a decision support system or operational support system Even though the environment is quite different from a large business organization, it would appear to be a decision support system at the tier one level because of the variety of open ended decision variables affecting both the input and output of the model. Certainly the expansion of the model into the tier two level makes it something beyond either an operational or decision support system, it becomes more specifically an expert system.

Systems Approach

The emergence of the systems concept as an identifiable discipline has lead to the development of the methodology associated with the study, design and analysis of systems. The basic components being; systems analysis, a study of the existing or purposed system; and systems design, the process of developing a new or revised system. Each phase of the process may contain many intermediate steps, and the overall

81. Barry E. Cushing, Accounting Information Systems and Business Organizations, 3rd ed. (Reading, Massachusetts: Addison-Wesley Publishing, 1982), 194-195.

process is typically dynamic in nature with frequent re-evaluations of the relationships found within a system. The basic design steps typically include: (1) Defining the system goals, (2) development of a conceptual model, (3) consideration of system constraints, (4) development of design alternatives, and finally (5) presentation of the general systems design proposal.

The final stages of the system development process usually involves the evaluation and justification of the proposed model, a detailed design of the system features, followed by the actual implementation of the purposed system.⁸²

The approach purposed by this research begins with a basic strategy for systems analysis and design. That is to begin by researching the basic needs of the system from a bottom-up approach, rather than a top-down approach.⁸³ By determining the individual system requirements, through the prescribed flow of transactions and information, the model can be built from the ground up. Certainly these concepts are not mutually exclusive. The process is dynamic, and

82. Robert G. Burch, Jr., et al., Information Systems: Theory and Practice, 3rd ed. (New York:John Wiley, 1983), 19-22.

83. Cushing, 323.

therefore the top-down view is often used to design specific input needs for the model.

Computer application programs can vary in complexity, but the process of developing them usually follows very specific steps: (1) a definition of the problem, (2) the development of a solution to that problem, (3) the coding of the program, (4) the testing and debugging of the program, followed by (5) the development of appropriate documentation supporting the program.⁸⁴

The approach taken in this research was to divide the analysis and design phases into two distinct components, tier one and tier two. Tier one being the decision support system model, and tier two the expansion of the model by addition of expert systems concepts. This process would provide the necessary detailed materials to understand the entire fiduciary responsibility system, as well as, make the difficult and complex process of adding artificial intelligence concepts a little more manageable.

Fiduciary Responsibility Summarized

The problem definition being addressed by this research is the lack of expertise in the area of fiduciary accounting. The purpose of the research is to establish a basis for developing a decision support system, which can be subsequently expanded into an expert system. The methodology

84. Nash and Roberts, 230.

purposed includes the research of the detailed requirements of the fiduciary responsibility system to identify its individual components, then to develop a flow chart of the system. Whereby the flow chart would assist in visualizing the precise logic that is required to achieve the solution, and would provide the basis for determining the common integration points between the various aspects of the system (legal, accounting, and income tax).

First step in analysis of the system of fiduciary responsibility is to examine the legal and accounting requirements. The legal and accounting process can be summarized as follows:

Estate assets are inventoried, valued and included in a Statement of Account.

Non-inventoried assets should be included for informational purposes as a memo entry, with associated distribution to appropriate beneficiaries documented.

Dispositions and transfers of assets should be presented.

Receipts and disbursements of estate income and principal should be reported.

Distributions of income and principal to individual beneficiaries should be reported.

Statement of Account should reflect property on hand at the end of the appropriate accounting period, after inclusion of the above

transactions.

These steps are presented in flow chart form in Appendix I of this paper.

The legal aspect focuses exclusively on the reports that must be made to the probate court. The format concerns with regards to this aspect are rather simple. The various formats documented in the appendixes of this paper indicate that in all of these examples the formats are practically identical. The legal requirements could simply be drawn from any adequate general accounting system. The major concern, for legal purposes, is that the specific format of the Statement of Account with subsidiary schedules be provided for. In addition, the system should detail those subsidiary schedules with individual transaction amounts. This merely requires that individual journal entries, for example individual cash receipts, must be maintained within the accounting system in their detailed form, without summary.

The accounting aspect of the fiduciary responsibility does not pose any great difficulty either. The research finds that the standard double-entry system of general ledger and associated journals is quite adequate and sufficient. This means that the programming found in the typical general ledger application program is appropriate. This is not to say that revisions in their format would not be appropriate, to the contrary, such items as liabilities would be handled quite differently. The research has pointed out those differences, and especially the differences in nomenclature.

The similarity is found in the process of setting up a chart of accounts, entering transactions, and closing of the books at various points in time.

The second step in the analysis of the fiduciary responsibility model is to examine the other aspect, estate income taxes. The income tax process can be summarized as follows:

Identify sources of taxable and tax-exempt income, and gains.

Identify sources of deductible expenditures.

Identify other deductions, including: capital losses, net operating losses, charitable deductions, estate tax deduction, and personal exemption.

Determine the amount of income distribution deduction.

Determine character of income distribution deduction to beneficiaries.

Determine allocation of deduction for depreciation depletion and amortization.

Compute fiduciary income tax.

Determine allocation of credits.

The above summary has been presented in much greater detail in Appendix J. The flow chart that is presented in the appendix shows that the income tax concepts can be pictorially represented, which will facilitate future programming of the model. The format of the income tax aspect of the model is unique. The proposed format would be in the

form of a worksheet, not an actual return. To have the report generated in actual tax return form, acceptable for filing, would be costly and time consuming. It usually requires the ability to program the output to be processed by a laser printer, and the final product must be acceptable to the Internal Revenue Service. The proposal is to provide a worksheet laid out in the same format as a tax return that could be used by the individual responsible for actually preparing the return. That person could prepare the final return manually or with the assistance of an application program designed to prepare fiduciary returns (not in widespread use yet, though available).

The key to the worksheet is that it will be integrated with the legal and accounting record keeping system, whereby the income tax report is always available as a menu option, since the necessary information for its completion are contained within the overall system. In practical terms, the income tax worksheet should present the two taxable components of the taxability of the estate; the fiduciary and the beneficiaries. The fiduciary portion of the report should segregate the income items into the categories found on the tax return: dividends, interest, income from partnerships, estates and trusts, net income from business and farm interests, net rental and royalty, capital and ordinary gains and losses, and other income. Deductions should be similarly classified as: interest, fiduciary fees, professional fees, and other deductions. It should also detail how calculations

were made for such items as the non-deductable portion of expenditures due to the existence of tax-exempt income, the estate tax deduction, and the income distribution deduction. The beneficiary statement must provide the detail necessary to adequately prepare the schedule K-1 (form 1041); including, apportionment of income items, allocation of depreciation, depletion and amortization, and identification of items passing through to the beneficiary upon termination of the estate.

Whether viewing the legal and accounting, or the income tax aspects of the fiduciary responsibility model, the formats for each are well documented in this paper.

Systems Integration Concerns

One of the primary benefits envisioned by this model is the integration of the fiduciary responsibility functions, in other words, a system that accomplishes a variety of tasks with only a single input. An examination of the systems flow charts in the appendix highlights how the integration between the legal and accounting, and income tax aspects could be accomplished.

Assets should be entered, both inventoried and non-inventoried, with a specific identification. Non-inventoried assets should automatically be shown as specific bequests to beneficiaries; to show the distribution in legal and accounting reports; and remove them from the income distribution deduction computation. The specific identification of assets will allow for the automatic identity of the distributions to

individual beneficiaries.

Beneficiaries should be identified, including name, address, and social security number. Thus when distributions are made the beneficiaries named can appear in the legal report, and the address and social security number will be noted for preparation of the income tax schedule K-1. Identification of beneficiaries should be provided for at the set-up of the chart of accounts and/or includable when distributions are actually recorded. Specific identification of assets and beneficiaries will allow for an option to automatically allocate estate distributions based upon any pre-established formula, for example, assets A to beneficiary X, 50% of remaining to beneficiary Y, etc. and remove the items from the inventory.

The proper account treatment of estate transactions is determined by the governing instrument. Thus, when transactions are entered into the accounting system their nature must be specified; assets dispositions, receipt of principal or income, disbursement of principal or income, and distributions of principal or income to beneficiaries.

When receipts of principal and income, and asset dispositions are recorded, their taxability should also be established. Therefore, if a cash receipt is recorded it must be initially identified as either income, principal, or an asset disposition; and then must be further identified as taxable, tax-exempt, or completely non-taxable. In addition, its classification as to the proper income category on the

fiduciary income tax return should be made (dividend, interest, etc.) and items of income in respect of a decedent should be identified.

When disbursements of principal and income are recorded for accounting purposes, certain tax consequences should be identified as well; those items subject to the tax-exempt income allocation should be flagged and the deduction should be categorized in the same fashion as shown on the fiduciary income tax return (interest, fiduciary fees, etc.) and items of deduction in respect of a decedent should also be identified.

Disbursements of principal and income that represent payments to charity must have those items qualifying for the estate income tax return deduction (paid from gross income) identified.

Distributions of income and principal to beneficiaries must be segregated between those required and all other distributions for purposes of computing the income distribution deduction.

If there is income in respect of a decedent, the system should automatically request the information necessary to compute the estate tax deduction, including the estate tax attributable to the inclusion of the item of income in respect of a decedent in the estate tax computation.

Any special allocation of gains, deductions or credits for fiduciary income tax purposes must be incorporated into the system.

The system should allow the fiduciary to elect to recog-

nize gains and losses on assets distributed to beneficiaries on the income tax portion of the model without affecting the gain or losses reported in the legal or accounting reports. When the election is indicated in the general set-up, then whenever a distribution is recorded the system should prompt the user for the additional information necessary to compute the income tax gain or loss properly.

The preceding items highlight the interface concerns of any model proposing to integrate the various aspects of the fiduciary responsibility associated with a decedent's estate administration. The major interfaces occur between the legal and accounting, and income tax aspects through the recording of transactions; receipts, disbursements and distributions.

Options, Menus and Formats

The basic concerns of the tier one portion of the model has been presented in some detail; now some examples will be presented to show the practical application of those concerns.

Most application programs are menu driven, and the model at hand should be no exception. The main menu would be envisioned to include three sections entitled: design, input and output. The design portion would have as menu options initial client set-up and subsequent changes. This would include a chart of account set-up option (major headings in the statement of account would be already defined, but user should be able to customize subsidiary schedule headings if requested), including estate name, date of death and iden-

tifying numbers; also the ability to add or delete the beneficiaries names, addresses or social security numbers, or make adjustments to the chart of accounts.

The input section of the main menu would consist of the following choices: input/correct transactions (including a posting feature to update master file), close books for tax purposes, or close books for legal/accounting purposes. These options would allow the user to access the files to add or correct transactions, to close the books for income tax purposes only, or close them for accounting purposes. Two closing methods would be provided because the books for tax purposes are not necessarily closed at the same time as is required for legal purposes. The options should also include an estate final closing choice (which should occur automatically if all properties are distributed) for those cases when all of the assets have not actually been distributed.

The final menu section is for output. The print options should include the ability to print either to a printer or to the display screen. The choices should also allow the printing of the following reports, or some combination thereof; general ledger, journals, legal (court) report, fiduciary tax worksheet, and the beneficiary K-1 worksheet.

Another important format feature of the system is the data input function. For example, in order to enter cash receipts through the input/correction transaction input option, an entry format must appear on the display screen. That display would request the following information: date,

amount, description of tax category, and account number. The date and the amount are self-explanatory. The purpose of the description field is two-fold, it is standard for documentational purposes in an accounting system and it provides the description that will be printed in the court reports. The tax category field would require entry of a code to properly identify it, as for example, taxable, tax-exempt, etc. The entry of some symbol such as an "*" at the input screen would trigger a listing of the choices available to the user which would identify the tax characteristics of an individual input item. Finally, the account number would identify the proper posting reference for the item in terms of the accounting and legal reports. For example, an accounting nominal account posting to any number between 6000 and 6999 might represent receipts of income, as opposed to receipts of principal, on the legal report.

System Software Requirements

The programming of the tier one portion of the model can be drawn directly from the flow charts and topical discussion presented. The actual programming has not been done as explained earlier in this paper. But there are system software concerns that, as with most any system, impact this model. These concerns include system controls and documentation.

The actual programming of the model must be conducted with certain control notions in mind. The systems should have basic controls embedded in its design to prevent errors, both intentional and unintentional.

The controls insure the proper functioning of the system and makes certain that accuracy and consistency is maintained during the processing of the systems transactions.⁸⁵ The controls, or programming checks, include:

Control, hash, or verification totals: whereby computer totals are accumulated for dollar amounts and/or codes for batched transactions, for comparison to totals prepared by the system user, to identify differences that may represent incorrect data entry.

Procedural controls: whereby certain menu functions will prompt an additional user response before processing occurs. For example, before the books can be closed (thus eliminating prior transaction details) the user is asked if they are sure they want to close the books.

Completeness checks: whereby all necessary information fields must be completed prior to allowing the user to proceed.⁸⁶

Error messages: whereby operational problems are

85. Elias M. Awad, Systems Analysis and Design (Homewood, Illinois; Richard D. Irwin, 1979), 166-167.

86. Awad, 169.

identified and displayed to the user of the program. For example, a division by zero message indicates that a zero has been encountered in an expression or operation of a calculation.

Finally, documentation is also an important control aspect of any system. The system documentation should be clear and concise for all users of the system, whether a preparer or an operator of the program. The documentation should also be updated as necessary to insure its relevance.⁸⁷

Systems Limitations

The model being proposed does have certain limitations that must be presented. First, the system includes, to a large part, reliance upon current tax law. For this reason, the dynamic nature of income tax law, with its constant law revisions and court interpretations, will result in the need to constantly update the programming. Fortunately though the legal and accounting aspects of the system are more static and will not cause the need for constant changes.

The second limitation of this program pertains to state law. This has two aspects: state law in terms of the legal

87. The Use of Computers in Tax Return Preparation (New York: American Institute of Certified Public Accountants, 1987), 9.

requirements of an estate, and the state income tax laws relating to estates of decedents. In this research the laws of California have been used for the legal and accounting aspects of the fiduciary responsibility, which therefore, to one extent or another, makes this program not useful elsewhere. In addition, the program is based for income tax purposes on federal law, not on those of the state of California. Fortunately, the state of California recently enacted legislation to conform state law to federal for many aspects of individual taxation. Therefore the worksheet generated by this model should be quite useful in meeting the state of California estate income tax filing requirements.

The final limitation pertains to the fact that the tier one system does not eliminate the need for professionals to assist the user of the program. It does not, and should not, replace the need for attorneys, accountants, and other appropriate professionals. The system, whether a decision support system or an expert system, must be careful not to step over appropriate professional boundaries. For example, it should not be viewed as acting in a manner that represents the unauthorized practice of law.

Conclusion

This chapter has indicated how the detailed aspects of the various fiduciary functions of a decedents estate can be integrated into a decision support system. The format and design of such a system can be found in the text and appendixes. Suggestions for options, menus and programming in-

tegration have been highlighted. Thus the tier one level of the model is complete, other than actual programming, and the final step is to discuss the expansion of the model to include the tier two expert systems considerations. This expansion will be discussed in the following, and concluding chapter.

CHAPTER 5

Expert System and Conclusion

Introduction

This final chapter will discuss the possible expansion of the decision support system, presented previously, into an expert system, further research opportunities opened by this research, and some concluding comments.

Expert Systems Definition

Artificial intelligence is a sub-discipline of computer science that is concerned with the development of computer systems that produce results that are usually associated with human intelligence. Artificial intelligence has been divided into various branches, based upon the task to which this concept has been applied. Namely, robotics, natural language processing and expert systems. Expert systems refer to computer programs that employ symbolic knowledge to simulate the reasoning behavior of human experts.⁸⁸ Natural language processing refers to a simpler user interface between the user and computer, by way of the use of natural spoken language to communicate, rather than the typical computer input language.

88. Brad Pollack, Artificial Intelligence (California CPA Computer Show and Conference, Los Angeles: California Society of Certified Public Accountant, August 5, 1987).

Expert systems are computer programs that capture specific expertise and apply that expertise to solve problems using a reasoning process similar to that of the original expert; involving book knowledge and rules of thumb gained by experience.⁸⁹ Expert systems typically model decision making in domains of knowledge that are more unstructured; not the structured domain of application programming associated with tax compliance procedural processing.⁹⁰ Thus the modular approach of this research appears to be appropriate for development of an overall model.

The typical structure of an expert system consists of a knowledge base, inference control mechanism, and explanatory facility. The knowledge base is comprised of a set of rules and a fact database. This represents the semantic network, where there is a link up of objects with attributes (as in the human brain), but is more often simply structured by the use of the object, attribute, and value approach. The knowledge base may be rule based, whereby the method of rep-

89. A. Faye Borthich and Owen D. West, "Expert Systems - A New Tool for the Professional," Accounting Horizons 1, no. 1 (March 1987): 11.

90. Robert H. Michaelsen and William F. Messier, Jr., "Expert Systems in Taxation," The Journal of the American Taxation Association 8, no.2 (Spring 1982): 7-8.

resentation in the decision process is an if-then format; if given circumstances exist, then some conclusion is appropriate. It is more linear and declarative in nature. Frame based knowledge bases are a more sophisticated representational model that contains both declarative knowledge, as well as can develop procedural knowledge directly from the use of the system.

The inference mechanism accepts the user interface input and pulls out the appropriate rules from the knowledge base to act upon that input. It is the set of code responsible for choosing rules and then making inferences from those rules. The goal is defined by the user of the system, the expert system then draws upon the rules to reach that goal; gathering data from the user or database to arrive at some conclusion.

The final component of an expert system is usually the explanatory facility. This portion draws from the inference mechanism descriptions of the reasoning process used in arriving at the conclusion the system has generated. In other words it explains and justifies its conclusion. For the user of the expert system, this could possibly be the most important aspect of the system, explaining why the computer reached the conclusion it did.

Expert systems are still in their infancy, and most recent commercial developments do not represent true artificial intelligence, but only fancy application programs.

Expert Systems Opportunities and Limitations

The need for expert systems is obvious from the opportunity they present to capture expertise, a scarce resource, and preserve that expertise for others to use for a variety of reasons.⁹¹ Applications of this new technology, in its more pure form, has been rather limited, including applications in medical diagnosis and geological exploration.

The application of expert systems has begun to expand into accounting problem domains such as auditing of accounts receivable, advanced computer systems, and in tax planning. But most programs have been experimental in nature, useful perhaps only as a tool to aid users in decision making. The application of expert systems can be accomplished if the rules of taxation can be captured by knowledge engineers. The resulting systems could be used for compliance and planning purposes, as well as for educational purposes.⁹²

The benefits of an expert system include: preserving and distributing expertise (especially when it is a scarce resource), maintaining consistency in application of the expertise, and facilitating training.⁹³

91. A. Faye Borthick and Owen D. West, 11-12.

92. Robert H. Michaelsen and William F. Messier, Jr., 7-12.

93. A. Faye Borthick and Owen D. West, 15.

The limitations on how effective an expert system can be, include: complex problems that require rules that can not be easily represented by current representational languages, disagreement amongst experts as to the correct rules, and finally, some complex problems may not have solutions within the system, and thus the conclusion of the system could be erroneous.⁹⁴

Expert Systems Fiduciary Application

The application of the expert system concept to fiduciary accounting is totally unique; but its appropriateness is quite apparent. This appropriateness is due to the apparent lack of widespread expertise regarding this specific topic.

The model would be developed from one of the programming languages of artificial intelligence, Turbo Prolog⁹⁵ (there are many others), which the author obtained as part of this research. Turbo Prolog is a commercial version of the original version developed in France in 1972 as an aid in programming in logic, hence the name Prolog.

Prolog is an object-oriented language which emphasizes symbolic processing. The program consists of data and the relationship among the data, from which unstructured problems

. A. Faye Borthick and Owen D. West, 14.

. A Trademark of Borland International, Inc.

can be solved. The user establishes the goal and the program uses a formal reasoning process in attempting to prove or disprove the goal based on the data in the knowledge base.⁹⁶

The methodology proposed by the research can be viewed as a series of steps, conducted subsequent to completion of the tier one module development, as follows:

- (1) a definition of the problem; the need for expertise in fiduciary accounting.
- (2) development of a specific knowledge domain framework; by itemizing the decision input variables (subjective methods), research the criteria of expert decision making (formal reasoning), and integrating the variables with the criteria.
- (3) Define the systems rules in natural language, and in pictorial representations, if appropriate.
- (4) The knowledge engineer (the individual processing the computer language expertise) then designs and builds the systems using the Prolog language.⁹⁷

96. Carl Townsend, Introduction to Turbe Prolog (Berkeley: Sybex, 1987), 3-4.

97. Carl Townsend, 4.

(5) The program is finally tested and debugged.

One major limitation that will have to be addressed as this developmental process is undertaken is the physical capacity of the chosen language to handle the necessary calculations involved in a complex system. The software manufacturer had to impose certain limitations on Turbo Prolog, not found in the traditional language, to make the product marketable at a reasonable cost.

Thus the size of the system is limited to the amount of memory available, and virtual memory is not automatically supported.⁹⁸ It is uncertain at this time whether a simply commercial language will be sufficient to meet the needs of this particular domain, or whether during development, round-about methods could be utilized. If not, the first three steps in the expert system proposed earlier would not be affected anyway, only the fourth step would be changed.

One final system consideration centers on the ability to integrate the tier one and tier two levels of the model. In other words, can a decision support system programmed in one language be integrated with the expert system programmed in another language. Possibly two separate systems will be necessary, but this issue is left for further research. In addition, the development of the specific knowledge domain framework for the expert system will require additional re-

98. Carl Townsend, 10-11.

search.

This presentation will not address the need for additional research into: the basic characteristics of an experts judgmental processes,⁹⁹ or the evaluation of the effectiveness and efficiency that expert systems are offering to the decision making process.¹⁰⁰

The development of the expert system domain could address such fiduciary responsibility issues as:

Providing assistance in determining proper distribution pattern to beneficiaries based upon the will or law of succession.

Providing assistance in determining proper allocation of items of principal and income according to the terms of the will or the Revised Uniform Principal and Income Act.

Providing assistance in determining proper tax treatment of includable items of income or deduction.

Providing assistance in identifying and classifying individual assets.

Providing assistance to the fiduciary in terms of asset valuations (especially when no estate

99. Robert H. Michaelsen and William F. Messier, Jr., 19.

100. A. Faye Borthick and Owen D. West, 16.

tax return was required) and analysis of title implications to the probate estate. Providing assistance to the fiduciary in determining probate vs. non-probate assets. Providing assistance to the fiduciary by inclusion of a post-mortem checklist, facilitating proper estate administration.¹⁰¹

Thus the expansion of the model into an expert system is possible, and the benefits of such a prospect are enormous.

Conclusion

This research has examined a unique form of accounting and taxation, and has shown that an integration of that topic is possible. The legal, accounting and income tax aspects of a decedents estate, comprising the overall fiduciary responsibility, has not previously been integrated in the manner proposed by this paper.

A logical framework for development of an integrated expert system for fiduciary accounting has been presented. The approach is modular, with tier one being based upon the development of a decision support system, provides flow charts to facilitate programming, and offers suggestions as

01. See post-mortem checklist in: Lawrence Brody, "A Post-mortem Checklist: What a Planner Needs to Know When A Client Dies," The Journal of the Institute of Certified Financial Planners 6. no.4 (Winter 1985): 197-212.

to format and menu construction. This in turn provides the basis from which the expert system can be developed. The process of that subsequent development has been presented.

The problem as defined by this research is the lack of expertise in the fiduciary area of accounting and taxation. The solution is to develop an expert system that can fill that void. The methodology to arrive at that solution is represented in the textual material of this paper.

The solution, if fully developed, would assist all potential users of the system, including accountants, attorneys, fiduciaries, institutional trust officers, and government employees. The expert systems value is not in much doubt, and even the mere development of a working tier one model would offer much to meeting user needs. In addition, the integration of these topics will provide a basis from which future research can be conducted, and one could also find it being utilized in classroom teaching applications.

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APPENDIXES

Appendix A:

Actual Court Fiduciary Report Format, Example no. 1.¹

1. Actual report of a decedents estate presented to a court obtained from the author. The names have been removed to protect the privacy of the individuals involved.

ESTATE OF
SCHEDULE A - PROPERTY ON HAND
NOVEMBER 25, 1984

Cash

Home Savings & Loan Money market checking account #108- 14070 Ventura Boulevard Sherman Oaks, California 91423	\$ 14,069.79
Shearson American Express Cash Balance in account #559- at November 25, 1985	<u>651.66</u>
	<u>\$ 14,721.45</u>

Stocks

100 shares Atlantic City Electric	\$ 2,468.75
100 shares Florida Progress	2,343.75
100 shares Gulf State Utilities Co.	1,262.50
150 shares Houston Industries, Inc.	3,213.75
2,200 shares Pacific Gas & Electric	36,437.50
100 shares Pacific Gas & Electric - Preferred 12.80%	<u>2,493.75</u>
	<u>\$ 48,250.00</u>

Government Securities

U.S. Treasury Bill Due date: 3/28/85 (26 week) Face amount: \$20,000.00	\$ 19,452.00
U.S. Treasury Bill Due date: 2/21/85 (13 week) Face Amount: \$50,000.00	49,020.00
U.S. Treasury Bill Due date: 3/14/85 (26 week) Face amount: \$20,000.00	19,510.00

ESTATE OF
 SCHEDULE A - PROPERTY ON HAND
 NOVEMBER 25, 1984

U.S. Treasury Bill	
Due date: 1/31/85 (13 week)	
Face amount: \$60,000.00	59,148.00
	\$147,130.00

Bonds

10,000 California Pltn Ctl Fin Auth Rev Ser A - Pacific Gas & Electric 12.375% due 6/1/2022	
Accrued interest	\$ 10,700.00 601.56
5 Units Corp Income Fund #84M	3,593.45
5 Units Corp Income Fund #1M GNMA	2,779.95
5,000 Crestline Lake Arrowhead California Water Agency 05.00% due 1/1/1994	3,650.00
Accrued interest	102.77
15,000 Excelsior California UN HSD-dtd 1964 - 03.700% due 10/1/1986	14,175.00
Accrued interest	86.33
5 Units Municipal Bond Trust #19	4,778.25
2 Units Municipal Inv. Trust #8M Fund California Ser 8	1,782.20
10 Units Municipal Inv. Trust #10M Fund California Ser 10	11,309.80
5 Units Municipal Inv. Trust Fund #56M	4,199.45
3 Units Municipal Inv. Trust Fund #102M	2,067.57
105 Units Nuveen TEBF Mlt St #19M California	9,530.85
5,000 Pacific Gas & Electric 1st & Ref Mtg SERTT - Reg - 9.00% - due 12/1/2001	3,231.25
Accrued interest	222.50

ESTATE OF

SCHEDULE A - PROPERTY ON HAND

NOVEMBER 25, 1984

10,000 Richmond California Municipal Sewer DT #1 dtd 2/15/68 04.500% due 6/15/1986	9,600.00
Accrued interest	203.75
25,000 San Bernardino Co. California MFRV - A Redlands Federal Savings & Loan Assoc. - Regd - 09.00% - due 4/1/1998	25,250.00
Accrued interest	350.00
35,000 Southern California Public Authority Power Project Rev Ser B - Dated 11/1/82 10.125% due 7/1/2001	35,350.00
Accrued interest	1,456.88
50,000 Vista California Loans to Lenders Regd - Investment Savings & Loan Association 09.750% due 12/1/1997	51,500.00
Accrued interest	2,410.41
5,000 Curtis Creek California School District - dated 5/1/70 - 6.900% due 5/1/1986	4,925.00
Accrued interest	23.95
27,672 GNMA Income Fund - 1	20,322.37
50 Units Municipal Investment Trust #26	51,169.00
	<u>\$275,372.79</u>

Notes Receivable

Burton Rate: 10.00% Monthly payments of principal and interest in the amount of \$125.00	\$ 605.00
Johannes Rate: 15.00% Monthly payments of principal and interest in the amount of \$594.75 until paid in full	6,076.93
	<u>\$ 6,681.93</u>
Total property on hand at November 25, 1984	<u>\$492,156.17</u>

ESTATE OF
 SCHEDULE B - CASH RECEIPTS OF INCOME ITEMS
 FROM NOVEMBER 25, 1984 THROUGH AUGUST 31, 1985

<u>Date</u>	<u>Payor</u>	<u>Description</u>	<u>Amount</u>
5/24/85	Central Savings	Interest	290.12
5/28/85	AARP Health Insurance	Premium Refund	70.34
5/28/85	GNMA	Interest	250.10
5/28/85	Central Savings	Interest	99.73
5/31/85	Municipal Inv. Trust #8	Interest	15.12
5/31/85	Municipal Inv. Trust #10	Interest	96.40
5/31/85	Municipal Inv. Trust #26	Interest	384.00
5/31/85	Shearson Daily Dividend, Inc.	Interest	107.92
6/3/85	California Pltn Ctl Fin Auth.	Interest	618.75
6/3/85	Vista California Loans to Lenders	Interest	2,437.50
6/3/85	Pacific Gas & Electric	Interest	225.00
6/10/85	Houston Industries, Inc.	Dividend	99.00
6/13/85	Los Angeles Federal Savings	Interest	447.23
6/17/85	Gulf States Utilities Co.	Dividend	41.00
6/17/85	Municipal Inv. Trust #19	Interest	32.55
6/17/85	Municipal Inv. Trust #56	Interest	29.20
6/17/85	Municipal Inv. Trust #102	Interest	16.20
6/17/85	Nuveen Multi State #19	Interest	80.78
6/17/85	Richmond California Municipal Sewer District	Interest	225.00
6/17/85	Corporate Income Fund #84	Interest	37.25
6/17/85	Home Savings of America	Interest	88.10

ESTATE OF
 SCHEDULE B - CASH RECEIPTS OF INCOME ITEMS
 FROM NOVEMBER 25, 1984 THROUGH AUGUST 31, 1985

<u>Date</u>	<u>Payor</u>	<u>Description</u>	<u>Amount</u>
6/19/85	Johannes	Interest	35.82
6/20/85	Florida Progress Corp.	Dividend	54.00
6/20/85	Home Savings of America	Interest	7.81
6/24/85	Corporate Income Fund #1	Interest	23.10
6/26/85	Central Savings	Interest	375.71
6/26/85	GNMA	Interest	248.91
6/26/85	Internal Revenue Service	Tax Refund	1,176.00
6/27/85	Los Angeles Federal Savings	Interest	447.23
6/28/85	Shearson Daily Dividend, Inc.	Dividend	107.11
6/30/85	Gibraltar Savings	Interest	1,357.38
7/1/85	Municipal Inv. Trust #8	Interest	13.20
7/1/85	Municipal Inv. Trust #10	Interest	93.80
7/1/85	Municipal Inv. Trust #26	Interest	384.00
7/1/85	Crestline Lake Arrowhead California	Interest	125.00
7/1/85	Southern California Public Power Authority	Interest	1,771.88
7/2/85	Johannes	Interest	28.83
7/15/85	Atlantic City Electric Co.	Dividend	64.50
7/15/85	Pacific Gas & Electric Co.	Dividend	1,012.00
7/15/85	Municipal Bond Trust #19	Interest	28.90
7/15/85	Municipal Inv. Trust #56	Interest	29.10
7/15/85	Municipal Inv. Trust #102	Interest	16.20

ESTATE OF
 SCHEDULE B - CASH RECEIPTS OF INCOME ITEMS
 FROM NOVEMBER 25, 1984 THROUGH AUGUST 31, 1985

<u>Date</u>	<u>Payor</u>	<u>Description</u>	<u>Amount</u>
/15/85	Nuveen Multi State #19	Interest	80.78
/15/85	Corporate Income Fund #84	Interest	37.35
/18/85	Home Savings of America	Interest	79.06
/23/85	Corporate Income Fund #1	Interest	23.05
/26/85	Shearson Daily Dividend, Inc.	Dividend	123.65
/27/85	Central Savings	Interest	391.13
/27/85	GNMA	Interest	248.30
/31/85	Municipal Inv. Trust #8	Interest	13.20
/31/85	Municipal Inv. Trust #10	Interest	93.80
/31/85	Municipal Inv. Trust #26	Interest	384.00
/1/85	Gibraltar Savings	Interest	469.28
/12/85	Gibraltar Savings	Interest	15.37
/8/85	Johannes	Interest	21.76
/15/85	Pacific Gas & Electric	Dividend	80.00
/15/85	Municipal Bond Trust #19	Interest	28.90
/15/85	Municipal Inv. Trust #56	Interest	29.10
/15/85	Municipal Inv. Trust #102	Interest	16.20
/15/85	Nuveen Multi State #19	Interest	80.78
/15/85	Corporate Income Fund #84	Interest	37.20
/19/85	Home Savings of America	Interest	87.96
/23/85	Corporate Income Fund #1	Interest	22.90
/23/85	Central Savings	Interest	279.37

ESTATE OF
SCHEDULE B - CASH RECEIPTS OF INCOME ITEMS
FROM NOVEMBER 25, 1984 THROUGH AUGUST 31, 1985

<u>te</u>	<u>Payor</u>	<u>Description</u>	<u>Amount</u>
27/85	GNMA	Interest	247.32
27/85	Gibraltar Savings	Interest	8.06
30/85	Shearson Daily Dividend, Inc.	Dividend interest	171.62
31/85	Gibraltar Savings	Interest	<u>17.37</u>
Total cash receipts of income items from November 25, 1984 through August 31, 1985			<u>\$ 35,103.95</u>

SCHEDULE B-1 CASH RECEIPTS OF ACCRUED INTEREST
FROM NOVEMBER 25, 1984 THROUGH AUGUST 31, 1985

<u>Date</u>	<u>Description</u>	<u>Amount</u>
12/3/84	California Pltn Ctl Fin Auth	\$ 601.56
12/3/84	Vista California Loans to Lenders	2,410.41
12/3/84	Pacific Gas & Electric	222.50
12/17/84	Richmond California Municipal Sewer District	203.75
1/2/85	Crestline Lake Arrowhead California	102.77
1/2/85	Southern California Public Power Authority	1,456.88
4/1/85	Excelsior California	86.33
4/1/85	San Bernardino Co. California	350.00
5/1/85	Curtis Creek California School District	<u>23.95</u>
Total cash receipts of accrued interest from November 25, 1984 through August 31, 1985		<u>\$5,458.15</u>

ESTATE OF
 SCHEDULE C - CASH DISBURSEMENTS, OTHER THAN FOR
 CAPITAL ITEMS

FROM NOVEMBER 25, 1984 THROUGH AUGUST 31, 1985

<u>Date</u>	<u>Payor</u>	<u>Description</u>	<u>Amount</u>
5/11/85	Stanley	Accounting Services	56.00
5/17/85	Leland	Inheritance Tax Referee-appraisal	477.00
5/17/85	Martin	Accounting Services	50.00
5/28/85	Social Security Administration	Reimbursement for overpaid benefits	464.00
6/14/85	Stanley	Accounting Services	465.00
7/17/85	Stanley	Accounting Services	1,385.00
7/31/85	and Company	Appraisal Services	75.00
8/13/85	Stanley	Accounting Services	2,865.00
8/21/85	Internal Revenue Service	Federal Estate Tax	51,341.50
8/23/85	State Treasurer	California Estate Tax	<u>12,965.00</u>
Total cash disbursed, other than for capital items from November 25, 1984 through August 31, 1985			<u>\$ 78,676.75</u>

ESTATE OF
 SCHEDULE F - RECEIPTS OF PRINCIPAL ITEMS
 FROM NOVEMBER 25, 1985 THROUGH AUGUST 31, 1985

<u>Date</u>	<u>Payor</u>	<u>Description</u>	<u>Amount</u>
3/25/85	Corporate Income Fund #1	Principal	10.55
3/28/85	Treasury Bill	Principal	19,452.00
4/1/85	Municipal Inv. Trust #8	Principal	163.14
4/1/85	Municipal Inv. Trust #10	Principal	169.30
4/9/85	Burton	Note Principal	19.71
4/9/85	Johannes	Note Principal	545.22
4/23/85	Corporate Income Fund #1	Principal	13.15
5/3/85	Johannes	Note Principal	552.03
5/23/85	Corporate Income Fund #1	Principal	14.25
5/31/85	Municipal Inv. Trust #8	Principal	237.44
5/31/85	Municipal Inv. Trust #10	Principal	521.40
6/19/85	Johannes	Note Principal	558.93
6/24/85	Corporate Income Fund #1	Principal	13.05
7/2/85	Johannes	Note Principal	565.92
7/23/85	Corporate Income Fund #1	Principal	15.30
8/8/85	Johannes	Note Principal	572.99
8/15/85	Corporate Income Fund #84	Principal	10.10
8/23/85	Corporate Income Fund #1	Principal	<u>13.80</u>
Total Receipts of principal items from November 25, 1984 through August 31, 1985			<u>\$154,157.16</u>

ESTATE OF
SCHEDULE G - CASH DISBURSEMENTS - CAPITAL ITEMS
FROM NOVEMBER 25, 1984 THROUGH AUGUST 31, 1985

<u>Date</u>	<u>Payor</u>	<u>Purpose</u>	<u>Amount</u>
8/21/85	Internal Revenue Service	Federal Estate Tax on behalf of	\$ 12.59
8/21/85	Internal Revenue Service	Federal Estate Tax on behalf of	<u>407.91</u>
Total cash disbursement - capital items from November 25, 1984 through August 31, 1985			<u>\$ 420.50</u>

ESTATE OF
SCHEDULE E - PROPERTY REMAINING ON HAND
AT AUGUST 31, 1985

Cash

Home Savings & Loan Money market checking account 14070 Ventura Blvd. Sherman Oaks, California 91423	108-	\$ 13,822.32
Shearson American Express Cash balance in account at August 31, 1985	559-	36.70
Central Savings P.O. Box 85511 San Diego, California 92138	033	39,319.22
Los Angeles Federal Savings 3 month certificate due 9-13-85 One Wilshire Boulevard Los Angeles, California 90017	14-	20,447.23
Los Angeles Federal Savings 3 month certificate due 9-27-85 One Wilshire Boulevard Los Angeles, California 90017	14-	20,447.23
Gibraltar Savings & Loan Association 3 month certificate #31 Fashion Square Sherman Oaks, California 91423	22-	10,969.66
Shearson American Express Shearson Daily Dividend Inc. at August 31, 1985	559-	<u>25,301.00</u>
		<u>\$130,343.36</u>

ESTATE OF
 SCHEDULE E - PROPERTY REMAINING ON HAND
 AT AUGUST 31, 1985

Stocks

100 shares Atlantic City Electric	\$ 2,468.75
100 shares Florida Progress	2,343.75
100 shares Gulf States Utilities Co.	1,262.50
150 shares Houston Industries, Inc.	3,243.75
2,200 shares Pacific Gas & Electric	36,437.50
100 shares Pacific Gas & Electric - Preferred 12.80%	<u>2,493.75</u>
	<u>\$ 48,250.00</u>

Bonds

10,000 California Pltn Ctl Fin Auth. Rev. Ser A - Pacific Gas & Electric 12.375% due 6/1/2022	\$ 10,700.00
5 Units Corp Income Fund #84M	3,312.05
5 Units Corp Income Fund #1M GNMA	2,641.95
5,000 Crestline Lake Arrowhead California Water Agency 05.00% due 1/1/1994	3,650.00
15,000 Excelsior California Un HSD - dtd 1964 - 03.700% due 10/1/1986	14,175.00
5 Units Municipal Bond Trust #19	4,778.25
2 Units Municipal Inv. Trust #8M Fund California Ser 8	1,379.62
10 Units Municipal Inv. Trust #10M Fund California Ser 10	10,619.10
5 Units Municipal Inv. Trust Fund #56M	4,199.45
3 Units Municipal Inv. Trust #102M Fund	2,067.57
105 Units Nuveen TEBF Met St #19M California	9,530.85
5,000 Pacific Gas & Electric 1st & Ref Mtg SERTT - Reg - 9.00% - 12/1/2001	3,231.25

ESTATE OF
 SCHEDULE E - PROPERTY REMAINING ON HAND
 AT AUGUST 31, 1985

10,000 Richmond California Municipal Sewer DT #1 dtd 2/15/68 04.500% due 6/15/1986	9,600.00
25,000 San Bernardino Co. California MFRV - A Redlands Federal Savings & Loan Assoc. - Regd - 09.00% - due 4/1/1998	25,250.00
35,000 Southern California Public Authority Power Project Rev Ser B - Dated 11/1/82 10.125% due 7/1/2001	35,350.00
50,000 Vista California Loans to Lenders Regd - Investment Savings & Loan Assoc. 09.750% due 12/1/1997	51,500.00
5,000 Curtis Creek California School District - dated 5/1/70 - 6.900% due 5/1/1986	4,925.00
27,672 GNMA Income Fund - 1	20,322.87
50 Units Municipal Investment Trust #26	<u>51,169.00</u>
	<u>\$268,401.96</u>

Note Receivable

Johannes Rate: 15.00% Monthly payments of principal and interest in the amount of \$594.75 until paid in full	<u>\$ 1,167.45</u>
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Appendix B:

Actual Court Fiduciary Report Format, Example no. 2.²

2. Actual report of a decedents estate presented to the court obtained from the author. The names have been removed to protect the privacy of the individuals involved.

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 IN COUNTY CLERK'S OFFICE
 A.M. AUG 10 1982 P.M.

BRIAN SONNATBY County Clerk
 By _____ DEPUTY

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IN THE SUPERIOR COURT OF _____ COUNTY

In the Matter of the Estate of _____)
 _____) NO. 82
 Deceased.) INVENTORY AND APPRAISEMENT

STATE OF _____)
 COUNTY OF _____) ss.

The undersigned, personal representatives on oath state :

The annexed schedules consisting of 2 sheets contain a true inventory of the estate, both community and separate, subject to probate which has come into my possession or to my knowledge, together with a statement of all encumbrances, liens or other secured charges against any of said items.

The fair net value of said items, as of the date of decedent's death on November 19, 1981, after deducting all the encumbrances, liens and other secured charges, is as listed on the annexed schedules and the totals for each classification thereof are as follows:

(1) Real property	\$	<u>82,000.00</u>
(2) Corporation stock		<u>21,787.50</u>
(3) Mortgages, bonds, notes, etc.		<u>40,000.00</u>
(4) Bank accounts and money		<u>162,539.44</u>
(5) Furniture and household goods		<u>2,500.00</u>
(6) Other personal property		<u>10,577.04</u>
TOTAL NET FAIR VALUE	\$	<u>319,403.98</u>
DECEDENT'S ONE-HALF SHARE	\$	<u>159,701.99</u>

Deceased.

<u>REAL PROPERTY</u>			
	Family home at 1209 North particularly described as follows, to-wit: The north 60 feet of the east 15.9 feet and the north 55 feet of the west 9.1 feet of Lot 10 and the north 60 feet of Lot 9, and the north 55 feet of Lot 11, Block 2, Andrews Addition, records of . Situated in the City of Parcel No. 221500-013-0		, more
	Appraised value:	Improvements 36,333 Land 4,313 TOTAL 40,646	MARKET VALUE \$50,000.00
(2)	Triplex located at 2810-2812-2814 6th Arlington, more particularly described as follows: Lots 3 and 4, Block 6, Tisdales Addition to , records of Parcel No. 910000-070-0	Appraised value: Improvements 11,160 Land 15,926 TOTAL 27,086	MARKET VALUE 32,000.00
<u>CORPORATION STOCK</u>			
(3)	350 shares of AT & T, held by decedent and spouse as joint tenants with right of survivorship. Value of each share at death 60-3/8	TOTAL	21,131.25
(4)	**25 shares of Montana Power Company, held by decedent and spouse as joint tenants with right of survivorship. Value of each share at death 261	TOTAL	656.25
<u>MORTGAGES, BONDS, NOTES, ETC.</u>			
(5)	U.S. Treasury Bonds, \$5,000 each, 8 of them, as follows: VI38 and V2064		40,000.00
<u>BANK ACCOUNTS AND MONEY</u>			
(6)	Money Market Certificates, including interest to date of death, as follows:		
	Cert. with First Interstate Bank		29,065.76
	Cert. with First Interstate Bank		14,048.41
	Cert. with First Interstate Bank		14,201.61
	Cert. with National Bank		25,316.84
	Cert. with Bank		10,000.00
	Cert. with Bank		10,000.00
	Banker's Acceptance No. with Bank		47,976.16

CONTINUED

CONTINUED

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Deceased.

R

CONTINUING	CONTINUING	CONTINUING
Savings Accounts, including interest to date of death, as follows:		
Account No.	First Federal Savings	2425.14
Account No.	Savings and Loan	2675.62
Account No.	Mutual Savings	4959.88
Account Nos.	at Bank of California	1870.02
<u>FURNITURE AND HOUSEHOLD GOODS</u>		2500.00
<u>OTHER PERSONAL PROPERTY</u>		
One life insurance policy with American Mutual Life Insurance Company, Policy No. on the life of the decedent in the face amount of \$1,000. Paid overage, as dividends, was		66.06
Cash surrender value of MONY insurance policy No. on the life of surviving spouse at time of decedent's death was		1996.91
Cash surrender value of MONY insurance policy No. on the life of surviving spouse at time of decedent's death was		<u>8514.07</u>
TOTAL ESTATE ---- \$319,403.98		
DECEDENT'S ONE-HALF INTEREST -- \$159,701.99		
Please note: Certain transfer were made for less than full consideration within the three years prior to decedent's death, but these have all been rescinded and all property of decedent has been reported in this estate.		

ESTATE OF
SCHEDULE A
NON-INVENTORIED ASSETS OF
AS OF OCTOBER 11, 1983

SUMMARY OF CASH

<u>Description</u>	<u>Total Face Value</u>
11 * Bank Money Market Certificate	\$35,000.00
12 * Bank Money Market Certificate	13,362.73
13 * Bank Money Market Certificate	13,362.73
14 *First Interstate Certificate of Deposit	18,081.77
15 *First Interstate Certificate of Deposit	37,006.93
16 *First Interstate Certificate of Deposit	16,690.29
17 * Bank Money Market Account	31,500.00
18 *Bank of California Passbook Account	2,146.54
19 *Bank of California Passbook Account	<u>436.49</u>
20 TOTAL CASH	<u>\$167,587.48</u>

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ESTATE OF
SCHEDULE A
NON-INVENTORIED ASSETS OF
AS OF OCTOBER 11, 1983

SUMMARY OF ASSETS OTHER THAN CASH

Stocks

*400 shares of AT & T at \$65.00 per share (valued as of November 23, 1983)	\$26,000.00
25 shares of Montana Power at \$10.00 per share	<u>250.00</u>
TOTAL STOCKS	<u>\$26,250.00</u>

Real Property

6th	\$50,000.00
Cedar	55,000.00
Deerfork	<u>200.00</u>
TOTAL REAL PROPERTY	<u>\$105,200.00</u>

Recapitulation

Balance of Cash	\$167,587.48
Stocks	26,250.00
Real Property	<u>105,200.00</u>
Beginning Balance of non-inventoried assets of as of October 11, 1983	<u>\$299,037.48</u>

The Petitioner's Amended First Account Current covers the period beginning October 11, 1983 and ending April 30, 1984.

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ESTATE OF
SCHEDULE B
RECEIPTS

INCOME RECEIPTS - MERRILL LYNCH

Cash Management Account

Interest

8-26-83	\$116.33
9-30-83	125.97
10-28-83	89.38
11-25-83	62.94
12-30-83	37.63
1-27-84	10.67
2-24-84	3.00
3-30-84	16.13
4-27-84	<u>20.96</u>

\$483.01

U.S. Treasury Bill

Interest

9-5-83	\$950.40
1-11-84	696.90
3-13-84	<u>947.40</u>

2,594.70

U.S. Treasury, Series H

Interest

11-11-83	\$850.00
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850.00

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ESTATE OF

SCHEDULE B

RECEIPTS

INCOME RECEIPTS - MERRILL LYNCH

TOTAL INCOME RECEIPTS - MERRILL LYNCH

\$13,463.61

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ESTATE OF

SCHEDULE B

RECEIPTS

OTHER INCOME RECEIPTS

First Interstate Certificate of Deposit

Interest 2-3-84 \$1,809.32

First Interstate Certificate of Deposit

Interest 10-31-83 \$715.13

Interest 4-30-84 790.95

1,506.08

Bank Money Market Account

Interest 4-4-84 1,623.10

TOTAL OTHER INCOME RECEIPTS

\$17,570.47

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ESTATE OF
SCHEDULE B
RECEIPTS

RENTAL INCOME

6th

8-8-83	\$350.00
9-5-83	350.00
10-3-83	350.00
11-3-83	350.00
11-11-83	225.00
12-5-83	350.00
1-4-84	350.00
1-13-84	225.00
2-4-84	350.00
2-17-84	225.00
3-1-84	225.00
3-2-84	350.00
4-3-84	<u>350.00</u>

TOTAL RENTAL INCOME

\$4,050.00

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ESTATE OF

SCHEDULE B

RECEIPTS

OTHER RECEIPTS

Money Market Account - Foster and
Marshall

Initial deposit to open account 11-8-83 \$35,364.98

Cash transfer from Foster and Marshall
into Merrill Lynch

CMA Account

Transfer

1-13-84 \$5,000.00

3-6-84 3,000.00

8,000.00

Merrill Lynch CMA Account

Initial deposit to open account 1-25-84 3,966.79

Merrill Lynch CMA Accounts:

From

Transfers

1-25-84 \$757.89

1-30-84 235.13

2-01-84 332.03

2-07-84 1,476.26

2-08-84 380.00

3,181.31

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ESTATE OF

SCHEDULE B

RECEIPTS

OTHER RECEIPTS

TOTAL OTHER RECEIPTS. \$50,513.08

Recapitulation

Income Receipts - Merrill Lynch \$13,463.61

Other Income Receipts 17,570.47

Rental Income 4,050.00

Other Receipts 50,513.08

TOTAL RECEIPTS DURING ACCOUNTING PERIOD \$85,597.16

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ESTATE OF

SCHEDULE C

DISBURSEMENTS

4-26-84	County Finance Director - taxes	\$251.20
4-26-84	County Finance Director - taxes	52.54
4-26-84	County Clerk - taxes	398.33
4-26-84	County Clerk - taxes	456.24
4-26-84	County Clerk - taxes	9.97
4-28-84	Renya - nursing care	140.00
4-28-84	Marta - nursing care	140.00
4-29-84	Guadalupe - nursing care	185.00
4-30-84	Ralph - legal fees	1,000.00
4-30-84	Ralphs - subsistence	<u>125.00</u>
	TOTAL DISBURSEMENTS - MERRILL LYNCH	
	CASH MANAGEMENT ACCOUNT	<u>\$44,665.93</u>

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ESTATE OF
SCHEDULE C
DISBURSEMENTS

OTHER DISBURSEMENTS

Money Market Account - Foster and Marshall	
Financial Management Account	
Annual Fee 3-13-84	\$100.00
Gold Card Charges 4-26-84	<u>120.15</u>
TOTAL OTHER DISBURSEMENTS	<u>\$50,733.23</u>

Recapitulation

Total Merrill Lynch Cash	
Management Account Disbursements	\$44,665.93
Total Other Disbursements	<u>50,733.23</u>
TOTAL DISBURSEMENTS DURING ACCOUNTING PERIOD	<u>\$95,399.16</u>

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ESTATE OF
SCHEDULE D
NON-INVENTORIED ASSETS OF
AS OF APRIL 30, 1984

SUMMARY OF CASH

<u>Description</u>	<u>Total Face Value</u>
Bank Money Market Certificate	\$43,468.59
Bank Money Market Certificate	13,995.05
Bank Money Market Certificate	13,995.05
First Interstate Certificate of Deposit	18,789.01
First Interstate Certificate of Deposit	38,816.25
First Interstate Certificate of Deposit	18,196.37
Bank Money Market Account	33,123.10
Bank of California Passbook Account	2,146.54
Bank of California Passbook Account	<u>436.49</u>
TOTAL CASH	<u>\$182,966.45</u>

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ESTATE OF
SCHEDULE D
NON-INVENTORIED ASSETS OF
AS OF APRIL 30, 1984

SUMMARY OF ASSETS OTHER THAN CASH

Stocks

400 shares of AT & T, as well as the appropriate shares in seven regional companies as a result of the divestiture	\$26,000.00
25 shares of Montana Power at \$10.00 per share	<u>250.00</u>
TOTAL STOCKS	<u>\$26,250.00</u>

Real Property

6th	\$50,000.00
Cedar	55,000.00
Deerfork	<u>200.00</u>
TOTAL REAL PROPERTY	<u>\$105,200.00</u>

Recapitulation

Balance of Cash	\$182,966.45
Stocks	26,250.00
Real Property	<u>105,200.00</u>
BALANCE OF NON-INVENTORIED ASSETS OF AS OF APRIL 30, 1984	<u>\$314,416.45</u>

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ESTATE OF

SCHEDULE E

AMOUNT OF PARTIAL NO.1 INVENTORY AND APPRAISEMENT

PROPERTY ON HAND AS OF APRIL 30, 1984

United States Silver Coins	\$1,005.00
Foster and Marshall Money Market Account	
	28,469.20
Merrill Lynch Cash Management Account #325	(1,769.67)
Merrill Lynch Cash Management Account #325	785.48
Mutual Life Insurance Company of New York	
Contract No.	1,000.00
Mutual Life Insurance Company of New	
Ordinary Life Policy No.	5,665.93
Knights of Columbus Benefit Certificate	
No. dated July 11, 1919	980.53
Four (4) Series H United States Savings Bonds	
Nos.	
	20,000.00
One (1) United States Treasury Bill, Account	
No. face amount \$15,000.00	14,303.10
One (1) United States Treasury Bill, Account	
No. face amount \$20,000.00	19,512.70
Household furniture and furnishings in the	
residence located at 1209 North	
	1,500.00

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ESTATE OF

SCHEDULE E

AMOUNT OF PARTIAL NO.1 INVENTORY AND APPRAISEMENT

PROPERTY ON HAND AS OF APRIL 30, 1984

Miscellaneous personal property belonging to
the located in the residence of the
situated at 196
Los Angeles, CA 90049

\$300.00

TOTAL AMOUNT OF PARTIAL NO.1 INVENTORY AND
APRRASEMENT PROPERTY ON HAND AS OF
APRIL 30, 1984

\$91,752.32

*Given
mzn 7/87*

Appendix C:
Proforma Court Report Format for Decedents Estate,
Example no. 1.³

3. Proforma fiduciary report format, obtained from Joseph K. Del Torto, Attorney at Law.

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EXHIBIT A -- ACCOUNT

Summary of Account

(From _____, 19__, to _____, 19__)

CHARGES

_____	[Either Inventory and Appraisalment or
Amounts Chargeable From Prior Accounts	\$. _____
Receipts (Schedule 1).	_____
Gains on Sales (Schedule 2).	_____
TOTAL CHARGES.	\$. _____

CREDITS

Disbursements (Schedule 3)	\$. _____
Losses on Sales (Schedule 2)	_____
Other Credits (Schedule 4)	_____
Property on Hand (Schedule 5).	_____
TOTAL CREDITS.	\$. _____

EXHIBIT A

Schedule 1 -- Receipts

[Record in chronological order the receipts during the account period, listing the amount of each appropriately as either principal or income, e.g.:]

<u>Date</u>	<u>Item</u>	<u>Principal</u>	<u>Income</u>
05/22/74	Payment, face value, promissory note by Joe E. Doaks dated 10/15/69.	\$5,000.00	
06/01/74	Divident -- Widget Co.	13.57	
06/30/74	Interest -- First Trust savings account		\$25.00
07/05/74	Divident -- Gadget Co.		10.35
	TOTAL RECEIPTS	\$5,013.57	\$35.35

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EXHIBIT A

Schedule 2--Gains & Losses on Sales

Inventory Item No. _____, _____ [describe]
Appraised at. \$ _____
Sold for. \$ _____
Gain or (Loss). \$ _____

EXHIBIT A

Schedule 3--Disbursements

[Record disbursements in chronological order in the same manner as receipts are recorded: See Schedule 1.]

<u>Date</u>	<u>Item</u>	<u>Amount</u>
5/19/74	Brown and Smith Funeral Home-- funeral expenses.	\$.393.50

EXHIBIT A

Schedule 4--Other Credits

[If personal representative should be credited with credits not stated elsewhere (except property on hand: see Schedule 5), then describe here, for reconciliation of account, e.g.:]

<u>Item</u>	<u>Inventory -Value</u>
Painting "Nude Bathers" by Jacques Lartiste, on loan to National Gallery of Art, Washington, D.C.	\$.12,000.00
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EXHIBIT A

Schedule 5--Property on Hand

[List all property remaining in personal representative's possession, for reconciliation of account, e.g.:]

Cash on hand.	\$15,256.48
Real property at 123 Cherry Lane, Citytown, California.	<u>56,800.00</u>
TOTAL PROPERTY ON HAND	\$72,056.48

Appendix D:
Proforma Court Report Format for Decedents Estate,
Example no. 2.⁴

4. Proforma fiduciary report format, obtained from Joseph
Vlad, Attorney at Law.

ATTACHMENT A
SUMMARY OF ACCOUNT
6/84 through 12/31/85
Second Account

Charges

Inventory	\$131,787.74
Receipts (Schedule A)	16,130.60
Miscellaneous Receipts (Schedule A-2)	447.17
Gain on Sales (Schedule B)	17,500.00
Miscellaneous Charge (Schedule B-2) Refund	150.41
	Escrow
Total Charges	<u>\$166,015.92</u>

Credits

Disbursements (Schedule C)	\$ 23,825.42
Loss on Sale (Schedule D)	50.00
Miscellaneous Credits (Schedule E)	1,077.74
Assets on Hand (Schedule F)	141,062.76
Total Credits	<u>\$166,015.92</u>

SCHEDULE A
CASH RECEIPTS

Date	To Whom/For What	Amount
1984	10/19/84 Balance	
11/1	Social Security Payment	\$486-
11/8	Interest Acct #053-106825-7 At Closing	77.39
10/31	Interest Acct #12-028007-3 At Closing	75.73
1985		
2/1	1984 Interest At Home Savings	1,210.95
	Escrow Refund Lancaster Home	335.63
	Social Security Check	503.00
	Deposit For Sale Of Dodge	15.63
	TOTAL	1,854.26
6/5	(6) Social Security Checks	3,018.-
7/23	Social Security Check	503.-
9/16	(2) Social Security Checks	1,006.-
10/17	Social Security Check	503.-
11/15	Social Security Check	503.-
12/12	Social Security Check	503.-
12/31	Interest Earned Home Savings	6,308.66
		<u>16,048.99</u>
	Subtotal Receipts	
	Trust Deed Net Interest	81.61
	TOTAL	16,130.60

MISCELLANEOUS RECEIPTS
SCHEDULE A-2

Unidentified receipts	447.17

SCHEDULE A - CONTINUED

Date	From Whom/For What	Amount
	Trust Deed Payments 100 x 15 Months	\$2,500.00
	Beginning Principal Balance	1,704.44
	+ Interest	2.70
		<u>1,707.14</u>
	Ending Balance 12/13/65	288.75
	Reduction In Principal	1,418.39
	Interest income	<u>81.61</u>
	Banking Charges On 3 of A 03045-62051 of \$47.50 are included in disbursements.	

SCHEDULE B

GAIN ON SALE

Sales Price	92,500.
Appraised Value	75,000.
	<hr/>
Gain	17,500.

MISCELLANEOUS CHARGE

SCHEDULE B-2

Escrow Refunds (Net Amount)

On Purchase of New Home

Per Escrow Statement,

Charges 189.21

Credits (339.62)

Net Charge Miscellaneous 150.41

NOTE: PURSUANT TO COURT AUTHORITY, PETITIONER PURCHASED A NEW HOME FOR DECEDENT, FOR \$67,000.00, as SHOWN ON ATTACHED ESCROW STATEMENTS. DUE TO PRORATION AND CREDITS GIVEN TO PETITION IN THE ESCROW FOR REPAIRS, THE NET PRICE WAS \$150.41 Less than said \$67,000.00 sale price; said \$150.41 is shown on this schedule as a charge, and the real property is included in the Assets on Hand at the price of \$67,000.00.

Appendix E:

The Revised Uniform Principal and Income Act.⁵

5. From the California Administration of Estates Code, Section 16300 et seqq., as amended to July 1, 1987.

Trustee may use any value finally determined for the purposes of an estate or inheritance tax.

(c) "Remainder beneficiary" means the person entitled to principal, presently or in the future, including income which has been accumulated and added to principal.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16302. Receipts and expenditures

(a) A trust shall be administered with due regard to the respective interests of income beneficiaries and remainder beneficiaries. A trust is so administered with respect to the allocation of receipts and expenditures if a receipt is credited or an expenditure is charged to income or principal or partly to each in any of the following ways:

(1) In accordance with the terms of the trust instrument, notwithstanding contrary provisions of this chapter.

(2) In the absence of any contrary terms of the trust instrument, in accordance with the provisions of this chapter.

(3) If neither paragraph (1) nor (2) is applicable, in accordance with the standard of care provided in Section 16040 and with what is reasonable and equitable in view of the interests of those entitled to income as well as of those entitled to principal.

(b) If the trust instrument gives the trustee discretion in crediting a receipt or charging an expenditure to income or principal or partly to each, no inference that the trustee has improperly exercised such discretion arises from the fact that the trustee has made an allocation contrary to a provision of this chapter.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16303. Income: principal

(a) Income is the return in money or property derived from the use of principal, including return received as any of the following:

(1) Rent of real or personal property, including sums received for cancellation or renewal of a lease.

(2) Interest on money lent, including sums received as consideration for the prepayment of principal except as provided in Section 16307 on bond premium and bond discount.

CHAPTER 3. REVISED UNIFORM PRINCIPAL AND INCOME ACT

Section

- 16300 Short title.
- 16301 Definitions.
- 16302 Receipts and expenditures.
- 16303 Income: principal.
- 16304 Right to income; apportionment.
- 16305 Income earned during administration of estate.
- 16306 Corporate distributions.
- 16307 Bonds and other obligations.
- 16308 Business and farming operations.
- 16309 Natural resources.
- 16310 Property subject to depletion.
- 16311 Underproductive property.
- 16312 Charges against income and principal.
- 16313 Depreciation or depletion; reserve or allowance.

Operative July 1, 1987.

§ 16300. Short title

This chapter may be cited as the Revised Uniform Principal and Income Act.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16301. Definitions

As used in this chapter:

(a) "Income beneficiary" means the person to whom income is presently payable or for whom it is accumulated for distribution as income.

(b) "Inventory value" means the cost of property purchased by the trustee and the market value of other property at the time it became subject to the trust, but in the case of a testamentary trust the

(3) Receipts allocated to income as provided in Section 16304.

(4) Income earned during administration of a decedent's estate as provided in Section 16305.

(5) Corporate distributions as provided in Section 16306.

(6) Accrued increment on bonds or other obligations issued at discount as provided in Section 16307.

(7) Receipts from business and farming operations as provided in Section 16308.

(8) Receipts from disposition of natural resources as provided in Section 16309.

(9) Receipts from other principal subject to depletion as provided in Section 16310.

(10) Receipts from disposition of underproductive property as provided in Section 16311.

(b) Principal is the property which has been set aside by the owner or the person legally empowered so that it is held in trust eventually to be delivered to a remainder beneficiary while the return or use of the principal is in the meantime taken or received by or held for accumulation for an income beneficiary. Principal includes the following:

(1) Consideration received by the trustee on the sale or other transfer of principal or on repayment of a loan or as a refund or replacement or change in the form of principal.

(2) Proceeds of property taken on eminent domain proceedings.

(3) Proceeds of insurance upon property forming part of the principal except proceeds of insurance upon a separate interest of an income beneficiary.

(4) Receipts allocated to principal as provided in Section 16304.

(5) Stock dividends, receipts on liquidation of a corporation, and other corporate distributions as provided in Section 16306.

(6) Receipts from the disposition of corporate securities as provided in Section 16307.

(7) Royalties and other receipts from disposition of natural resources as provided in Section 16309.

(8) Receipts from other principal subject to depletion as provided in Section 16310.

(9) Any profit resulting from any change in the form of principal except as provided in Section 16311 on underproductive property.

(10) Receipts from disposition of underproductive property as provided in Section 16311.

(11) Any allowances for depreciation established under Section 16308 and paragraph (2) of subdivision (b) of Section 16312.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16304. Right to income; apportionment

(a) An income beneficiary is entitled to income from the date specified in the trust instrument or, if none is specified, from the date an item of property becomes subject to the trust. In the case of an item of property becoming subject to a trust by reason of a person's death, it becomes subject to the trust as of the date of the death of the person even though there is an intervening period of administration of the person's estate.

(b) Upon property becoming subject to a trust by reason of a person's death:

(1) Receipts due but not paid at the date of death of the person are principal.

(2) Receipts in the form of periodic payments (other than corporate distributions to stockholders), including rent, interest, or annuities, not due at the date of the death of the person shall be treated as accruing from day to day. That portion of the receipt accruing before the date of death is principal and the balance is income.

(c) In all other cases, any receipt from income-producing property is income even though the receipt was earned or accrued in whole or in part before the date when the property became subject to the trust.

(d) If an income beneficiary's right to income ceases by death or in any other manner, all payments actually paid to the income beneficiary or in the hands of the trustee for payment to the income beneficiary before such termination belong to the income beneficiary or to his or her personal representative. All income actually received by the trustee after such termination shall be paid to the person next entitled to income by the terms of the trust. This subdivision does not apply to income received by a trustee under subdivision (b) of Section 16305.

(e) Corporate distributions to stockholders shall be treated as due on the day fixed by the corporation for determination of stockholders of record entitled

to distribution or, if no date is fixed, on the date of declaration of the distribution by the corporation.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16305. Income earned during administration of estate

(a) Unless the will otherwise provides, income from the property of a decedent's estate after the death of the testator and before distribution, including income from property used to discharge liabilities, shall be distributed in the manner set forth in Chapter 11 (commencing with Section 660) of Division 3. Income received by a trustee under this subdivision shall be treated as income of the trust.

(b) When an income beneficiary's right to income, including interest payable under Section 663, ceases by death or in any other manner during the period of probate administration, income attributable to the period prior to the termination of such right, when subsequently received by the trustee, shall be equitably prorated between the beneficiary or his or her personal representative and the person next entitled to income by the terms of the trust instrument.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16306. Corporate distributions

(a) Corporate distributions of shares of the distributing corporation, including distributions in the form of a stock split or stock dividend, are principal. A right to subscribe to shares or other securities issued by the distributing corporation accruing to stockholders on account of their stock ownership and the proceeds of any sale of the right are principal.

(b) Except to the extent that the corporation indicates that some part of a corporate distribution is a settlement of preferred or guaranteed dividends accrued since the trustee became a stockholder or is in lieu of an ordinary cash dividend, a corporate distribution is principal if the distribution is pursuant to any of the following:

- (1) A call of shares.
- (2) A merger, consolidation, reorganization, or other plan by which assets of the corporation are acquired by another corporation.
- (3) A total or partial liquidation of the corporation, including any distribution which the corporation indicates is a distribution in total or partial liqui-

dation or any distribution of assets, other than cash, pursuant to a court decree or final administrative order by a government agency ordering distribution of the particular assets.

(c) In the case of a regulated investment company or a trust qualifying and electing to be taxed under federal law as a real estate investment trust:

(1) Distributions made from ordinary income are income.

(2) All other distributions, including distributions from capital gains, depreciation, or depletion, whether made in the form of cash, an option to take new stock or cash, or an option to purchase additional shares, are principal.

(d) Except as provided in subdivisions (a), (b), and (c), all corporate distributions are income, including cash dividends, distributions of or rights to subscribe to shares or securities or obligations of corporations other than the distributing corporation, and the proceeds of the rights or property distributions. Except as provided in subdivisions (b) and (c), if the distributing corporation gives a stockholder an option to receive a distribution either in cash or in its own shares, the distribution chosen is income.

(e) The trustee may rely upon any statement of the distributing corporation as to any fact relevant under any provision of this chapter concerning the source or character of dividends or distributions of corporate assets.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16307. Bonds and other obligations

(a) Bonds or other obligations for the payment of money are principal at their inventory value, except as provided in subdivision (b) for discount bonds. No provision shall be made for amortization of bond premiums or for accumulation for discount. The proceeds of sale, redemption, or other disposition of the bonds or obligations are principal.

(b) The increment in value of a bond or other obligation for the payment of money payable at a future time in accordance with a fixed schedule of appreciation in excess of the price at which it was issued is distributable as income. The increment in value is distributable to the beneficiary who was the income beneficiary at the time of increment from the first principal cash available or, if none is available, when realized by sale, redemption, or other disposition. Whenever unrealized increment is distributed

as income but out of principal, the principal shall be reimbursed for the increment when realized.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16308. Business and farming operations

(a) If a trustee uses any part of the principal in the operation of a business, including an agricultural or farming operation, of which the settlor was a sole proprietor or a partner, the net profits and losses of the business shall be computed in accordance with recognized methods of accounting for a comparable business. Net profits from a business are income. Net losses from a business do not reduce other trust income for the fiscal or calendar year during which they occur but shall be carried into subsequent fiscal or calendar years and reduce the net profits of the business for those years.

(b) Subdivision (a) is subject to the provisions of Section 16313 and for this purpose any property of the business or agricultural or farming operation shall be deemed to be "trust property" within the meaning of Section 16313.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16309. Natural resources

(a) If any part of the principal consists of a right to receive royalties, overriding or limited royalties, working interests, production payments, net profit interests, or other interests in minerals or other natural resources in, on, or under land, the receipts from taking the natural resources from the land shall be allocated as follows:

(1) If received as rent on a lease or extension payments on a lease, the receipts are income.

(2) If received from a production payment, the receipts are income to the extent of any factor for interest or its equivalent provided in the governing instrument. There shall be allocated to principal the fraction of the balance of the receipts which the unrecovered cost of the production payment bears to the balance owed on the production payment, exclusive of any factor for interest or its equivalent. The receipts not allocated to principal are income.

(3) If received as a royalty, overriding or limited royalty, or bonus, or from a working, net profit, or any other interest in minerals or other natural resources, receipts not provided for in paragraphs (1)

and (2) shall be apportioned on a yearly basis in accordance with this paragraph whether or not any natural resource was being taken from the land at the time the trust was established. The receipts shall be allocated entirely to income or apportioned between income and principal as the trustee in its discretion may determine, but the amount added to principal as an allowance for depletion may not exceed the lesser of (A) the percentage of gross receipts allowed as a deduction for depletion in computing taxable income for federal income tax purposes or (B) 50 percent of the net receipts remaining after payment of expenses, direct and indirect, computed without allowance for depletion.

(b) This section does not apply to timber, water, soil, sod, dirt, turf, or mosses.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16310. Property subject to depletion

If the principal consists of property subject to depletion, other than property subject to Section 16309, including land from which merchantable timber may be removed and, when subject to depletion or amortization, leaseholds, patents, copyrights, royalty rights, and rights to receive payments on a contract for deferred compensation, receipts from the property shall be allocated entirely to income or apportioned between income and principal as the trustee in its discretion may determine, but in no event shall the amount allocated to principal exceed a reasonable allowance for depletion or amortization.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16311. Underproductive property

(a) Except as otherwise provided in this section, a portion of the net proceeds of sale of any part of principal which has not produced an average net income of at least 1 percent per year of its inventory value for more than a year, including as income the value of any beneficial use of the property by the income beneficiary, shall be treated as delayed income to which the income beneficiary is entitled as provided in this section. The net proceeds of sale are the gross proceeds received, including the value of any property received in substitution for the property disposed of, less the expenses, including capital gains tax, if any, incurred in disposition and less any

carrying charges paid while the property was underproductive.

(b) The sum allocated as delayed income is the difference between the net proceeds and the amount which, had it been invested at simple interest at 5 percent per year while the property was underproductive, would have produced the net proceeds. This sum, plus any carrying charges and expenses previously charged against income while the property was underproductive, less any income received by the income beneficiary from the property and less the value of any beneficial use of the property by the income beneficiary, is income, and the balance is principal.

(c) If principal subject to this section is disposed of by conversion into property which cannot be apportioned easily, including land or mortgages, (for example, real property acquired by or in lieu of a foreclosure), the income beneficiary is entitled to the net income from any property or obligation into which the original principal is converted while the substituted property or obligation is held. If within five years after the conversion the substituted property has not been further converted into easily apportionable property, no allocation as provided in this section shall be made.

(d) This section does not apply to securities listed on a national securities exchange or traded over the counter if the securities are held in a broadly diversified portfolio designed to produce a reasonable return appropriate to the purposes of the trust. (Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16312. Charges against income and principal

(a) After determining income and principal in accordance with the terms of the trust instrument or with this chapter, the trustee shall charge to income or principal expenses and other charges as provided in this section.

(b) The following charges shall be made against income:

(1) Ordinary expenses incurred in connection with the administration, management, or preservation of the trust property, including regularly recurring taxes assessed against any portion of the principal, water rates, premiums on insurance taken upon the interests of the income beneficiary, remainder beneficiary, or trustee, interest paid by the trustee, and ordinary repairs.

(2) The trustee in its discretion may make a reasonable allowance for depreciation on property subject to depreciation under generally accepted accounting principles, but no allowance shall be made for depreciation of that portion of any real property used by a beneficiary as a residence.

(3) One-half of court costs, attorney's fees, and other fees on periodic judicial accounting, unless the court directs otherwise.

(4) Court costs, attorney's fees, and other fees on other accountings or judicial proceedings if the matter primarily concerns the income interest, unless the court directs otherwise.

(5) One-half of the trustee's regular compensation, whether based on a percentage of principal or income, unless the court directs otherwise.

(6) All expenses reasonably incurred for current management of principal and application of income.

(7) Any tax levied upon receipts defined as income under this part or the trust instrument and payable by the trustee.

(c) If charges against income are of unusual amount, the trustee may by means of reserves or other reasonable means charge them over a reasonable period of time and withhold from distribution sufficient sums to regularize distributions.

(d) The following charges shall be made against principal:

(1) Trustee's compensation not chargeable to income under paragraphs (4) and (5) of subdivision (b), special compensation of trustees, expenses reasonably incurred in connection with principal, court costs and attorney's fees primarily concerning matters of principal, and trustee's compensation computed on principal as an acceptance, distribution, or termination fee.

(2) Charges not provided for in subdivision (b), including the cost of investing and reinvesting principal, the payments on principal of an indebtedness (including a mortgage amortized by periodic payments of principal), expenses for preparation of property for rental or sale, and, unless the court directs otherwise, expenses incurred in maintaining or defending any action or proceeding to construe the trust or protect it or the property or assure the title of any trust property.

(3) Extraordinary repairs or expenses incurred in making a capital improvement to principal, including special assessments, but a trustee may establish an

§ 16312

allowance for depreciation out of income to the extent permitted by paragraph (2) of subdivision (b) and by Section 16308.

(4) Any tax levied upon profit, gain, or other receipts allocated to principal notwithstanding denomination of the tax as an income tax by the taxing authority.

(5) If an estate or inheritance tax is levied in respect of a trust in which both an income beneficiary and a remainder beneficiary have an interest, any amount apportioned to the trust, including penalties, even though the income beneficiary also has rights in the principal.

(e) Regularly recurring charges payable from income shall be apportioned to the same extent and in the same manner that income is apportioned under Section 16304.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

§ 16313. Depreciation or depletion; reserve or allowance

The trustee is not required to set aside a reserve or allowance from trust income for depreciation or depletion of, or to amortize, any trust property unless the trust instrument expressly requires a reserve or allowance. Nothing in this chapter prevents a trustee in its discretion from establishing a reserve or allowance, or from continuing any previous practice of maintaining a reserve or allowance.

(Added by Stats.1986, c. 820, § 40.)

Operative July 1, 1987.

Appendix F:
Model Executor's Account.⁶

6. From the Committee on National Fiduciary Accounting Standards report entitled, "Uniform Fiduciary Accounting Principles and Model Account Format," dated May 1980.

MODEL EXECUTOR'S ACCOUNT

FIRST AND FINAL ACCOUNT OF
William C. Doe, Executor
For
ESTATE OF John Doe, Deceased

Date of Death: November 14, 1978
Date of Executor's Appointment: November 24, 1978
Accounting for the Period: November 24, 1978 to
November 30, 1979

Purpose of Account: William C. Doe, Executor, offers this account to acquaint interested parties with the transactions that have occurred during his administration.
The account also indicates the proposed distribution of the estate.

It is important that the account be carefully examined. Requests for additional information or questions or objections can be discussed with:

[Name of Executor, Counsel or other appropriate person]

[address and telephone number]

SUMMARY OF ACCOUNT

	<u>Page</u>	<u>Current Value</u>	<u>Fiduciary Acquisition Value</u>
Proposed Distribution to Beneficiaries	16-64	<u>\$ 102,974.56</u>	<u>\$ 90,813.96</u>
PRINCIPAL			
Receipts	16-55		\$ 160,488.76
Net Gain (or Loss) on Sales or Other Disposition	16-57		<u>2,662.00</u>
			<u>\$ 163,150.76</u>
Less Disbursements:			
Debts of Decedent	16-58	\$ 485.82	
Funeral Expenses	16-58	1,375.00	
Administration Expenses	16-58	6,156.34	
Fees	16-58	<u>11,689.64</u>	<u>19,706.80</u>
Balance before Distributions			\$ 143,443.96
Distributions to Beneficiaries	16-59		<u>52,630.00</u>
Principal Balance on Hand	16-60		<u>\$ 90,813.96</u>
For Information:			
Investments Made	16-61		
Changes in Investment Holdings	16-61		
INCOME			
Receipts	16-62		\$ 2,513.40
Less Disbursements	16-63		<u>178.67</u>
Balance Before Distributions			\$ 2,334.73
Distributions to Beneficiaries	16-63		<u>2,334.73</u>
Income Balance on Hand			-0-
Combined Balance on Hand			<u>\$ 90,813.96</u>

RECEIPTS OF PRINCIPAL

Assets Listed in Inventory (Valued as of Date of Death)		<u>Fiduciary Acquisition Value</u>
CASH:		
First National Bank — checking account	\$ 516.93	
Prudent Saving Fund Society — savings account	2,518.16	
Cash in possession of decedent	<u>42.54</u>	\$ 3,077.63
TANGIBLE PERSONAL PROPERTY:		
Jewelry —		
1 pearl necklace		515.00
Furniture —		
1 antique highboy	\$ 2,000.00	
1 antique side table	60.00	
1 antique chair	<u>55.00</u>	2,115.00
STOCKS:		
200 shs. Home Telephone & Telegraph Co., common	\$ 25,000.00	
50 shs. Best Oil Co., common	5,000.00	
1,000 shs. Central Trust Co., capital	50,850.00	
151 shs. Electric Data Corp., common	1,887.50	
50 shs. Fabulous Mutual Fund	1,833.33	
200 shs. XYZ Corporation, common	<u>6,000.00</u>	90,570.83
REALTY:		
Residence — 86 Norwood Road West Hartford, CT		<u>50,000.00</u>
Total Inventory		\$ 146,278.46
 <u>Receipts Subsequent to Inventory (Valued When Received)</u>		
2/22/79 Proceeds of Sale — Best Oil Co., rights to subscribe received 2/15/79	\$ 50.00	
3/12/79 Fabulous Mutual Fund, capital gains dividend received in cash	32.50	
5/11/79 Refund of overpayment of 1978 U.S. individual income tax	127.80	
9/25/79 From Richard Roe, Ancillary Administrator, net proceeds on sale of oil and gas leases in Jefferson Parish, Louisiana	<u>10,000.00</u>	\$ 10,210.30

ADJUSTMENT TO CARRYING VALUES
Increased value of 200 shs. XYZ Corporation,
common stock upon audit of Federal Estate Tax Return:

Adjusted value upon audit	\$ 10,000.00	
Value per Inventory	<u>6,000.00</u>	\$ <u>4,000.00</u>
Total Receipts of Principal		<u>\$ 160,488.76</u>

GAINS AND LOSSES ON SALES OR OTHER DISPOSITIONS

		<u>Gain</u>	<u>Loss</u>
2/7/79	100 shs. Home Telephone & Telegraph Co., common		
	Net Proceeds	\$ 14,025.00	
	Fiduciary Acquisition Value	<u>12,500.00</u>	
		\$ 1,525.00	
3/15/79	1,000 shs. Central Trust Co., capital		
	Net Proceeds	27,467.00	
	Fiduciary Acquisition Value	<u>25,425.00</u>	
		2,042.00	
3/15/79	200 shs. XYZ Corporation, common		
	Fiduciary Acquisition Value	10,000.00	
	Net Proceeds	<u>9,000.00</u>	
			\$ 1,000.00
5/21/79	35 shs. Electric Data Corp., common		
	Net Proceeds	530.00	
	Fiduciary Acquisition Value	<u>437.50</u>	
		92.50	
7/20/79	\$10,000 U.S. Treasury Bonds, 3%, due 7/1/82		
	Net Proceeds	10,000.00	
	Fiduciary Acquisition Value	<u>9,997.50</u>	
		2.50	
	Total Gains and Losses	\$ 3,662.00	\$ 1,000.00
	Less Loss	<u>1,000.00</u>	
	Net Gain	<u>\$ 2,662.00</u>	

DISBURSEMENTS OF PRINCIPAL

DEBTS OF DECEDENT			
1/25/79	John T. Hill, M.D., professional services	\$ 250.00	
4/12/79	State Tax Commissioner, 1978 state capital gains tax	156.00	
1/25/79	Thomas Pharmacy, prescriptions	23.82	
2/1/79	Sanders Hardware, purchases per bill dated 12/15/78	<u>56.00</u>	\$ 485.82
FUNERAL EXPENSES			
1/10/79	Smith Funeral Home, services	1,200.00	
2/15/79	Jones Memorials, grave marker	<u>175.00</u>	1,375.00
ADMINISTRATION EXPENSES			
11/14/78	Clerk of Court, probate costs	72.00	
2/22/79	Henry Smith, appraisal of jewelry and antiques	50.00	
11/16/79	Arden, Miles & Solomon, disbursements	56.00	
	Various miscellaneous affidavits, registered mail, toll telephone charges and other costs	<u>16.25</u>	194.25
FEDERAL AND STATE TAXES			
8/13/79	State Tax Commissioner, state death tax	2,501.33	
8/13/79	Internal Revenue Service, federal estate tax	2,663.29	
11/15/79	Internal Revenue Service, U.S. fiduciary income tax for fiscal year ending 7/31/78 (attributable to capital gains)	283.84	
11/23/79	Internal Revenue Service, deficiency in Federal Estate Tax interest 8/14/79 to 11/24/79	\$ 505.24 <u>8.39</u>	5,962.09
FEES			
11/16/79	Albert Schryver, Esq., fee as Guardian ad litem	375.00	
11/16/79	William C. Doe, Executor's principal commission 5% on \$50,000 4% on \$50,000 3% on \$60,488	6,314.64	
11/16/79	Arden, Miles & Solomon, attorney's fees	<u>5,000.00</u>	<u>11,689.64</u>
			<u>\$ 19,706.80</u>

DISTRIBUTIONS OF PRINCIPAL TO BENEFICIARIES

	TO: Janet Doe, in satisfaction of gift under Article FIRST of Will		
12/1/78	1 pearl necklace	\$ 515.00	
	1 antique highboy	2,000.00	
	1 antique side table	60.00	
	1 antique side chair	<u>55.00</u>	\$ 2,630.00
	TO: Janet Doe, in satisfaction of gift under Article SECOND of Will		
12/1/78	Residence — 86 Norwood Road		<u>50,000.00</u>
	West Hartford, CT		
	Total Distributions of Principal to Beneficiaries		<u>\$ 52,630.00</u>

THIS STATEMENT WAS PREPARED BY THE ACCOUNTING DEPARTMENT OF THE ESTATE OF JANET DOE, WEST HARTFORD, CONNECTICUT, ON 12/1/78.

PRINCIPAL BALANCE ON HAND

	Current Value 12/10/79 <u>or as noted</u>	Fiduciary Acquisition <u>Value</u>
Cash	\$ 5,305.63	\$ 5,305.63
Stocks:		
50 shs. Best Oil Co., common	4,500.00	5,000.00
1,000 shs. Central Trust Co., capital — value at most recent sale, 9/18/79	32,168.76	25,425.00
116 shs. Electric Data Corp., common — not traded, value per company books, 12/29/78	1,684.00	1,450.00
50 shs. Fabulous Mutual Fund	4,016.17	1,833.33
200 shs. Home Telephone & Telegraph Co., common	16,000.00	12,500.00
\$40,000 U.S. Treasury Bills due 12/14/79	<u>39,300.00</u>	<u>39,300.00</u>
	<u>\$ 102,974.56</u>	<u>\$ 90,813.96</u>

INFORMATION SCHEDULES — PRINCIPAL

		<u>Cost</u>	
INVESTMENTS MADE			
2/1/79	\$10,000 U.S. Treasury Bonds, 3%	\$ 10,022.50	
	Less accrued interest collected 6/29/79	<u>25.00</u>	
9/14/79	\$40,000 U.S. Treasury Bills, due 12/14/79		\$ 9,997.50
			39,300.00
CHANGES IN INVESTMENT HOLDINGS			
CENTRAL TRUST CO.			
11/14/78	1,000 shs. Capital stock, par \$5 inventoried		\$ 50,850.00
1/15/79	1,000 shs. additional received in 2 - 1 split, par reduced to \$2.50		
3/15/78	2,000 shs. par \$2.50 carried at <u>1,000</u> shs. sold, carried at	<u>50,850.00</u> <u>25,425.00</u>	
	<u>1,000</u> shs. remaining, carried at		<u>\$ 25,425.00</u>
HOME TELEPHONE & TELEGRAPH CO.			
11/14/78	200 shs. common par \$10, inventoried		\$ 25,000.00
2/7/79	<u>100</u> shs. sold, carried at	<u>12,500.00</u>	
	100 shs. remaining, carried at		12,500.00
3/30/79	100 shs. additional received in 2 - 1 split, par reduced to \$5		
	<u>200</u> shs. par \$5 carried at		<u>\$ 12,500.00</u>

RECEIPTS OF INCOME

DIVIDENDS

Best Oil Co., common 1/2/79 to 10/2/79 — 50 shs.		\$ 20.00	
Central Trust Co., common 1/15/79 — 2,000 shs.	\$ 600.00		
4/13/79 to 10/15/79 — 1,000 shs.	<u>900.00</u>	1,500.00	
Electric Data Corp., common 12/29/78 to 3/30/79 — 151 shs.	30.20		
6/29/79 to 9/28/79 — 116 shs.	<u>23.20</u>	53.40	
Fabulous Mutual Fund 3/12/79 to 9/12/79 — 50 shs.			140.00
Home Telephone & Telegraph Co., common 2/1/79 — 200 shs.	225.00		
5/1/79 to 11/1/79 — 200 shs. (after stock split)	<u>450.00</u>	<u>675.00</u>	\$ 2,388.40

INTEREST

U.S. Treasury Bonds, 3%, due 7/1/82 6/29/79 — \$10,000	150.00		
Less: accrued interest paid on purchase 2/1/79	<u>(25.00)</u>	<u>125.00</u>	<u>125.00</u>
	Total		<u>\$ 2,513.40</u>

DISBURSEMENTS OF INCOME

11/15/79	U.S. Fiduciary Income Tax for fiscal year ended 7/31/79 (allocable to income)	\$ 53.00
	To be paid:	
	William C. Doe — Executor's income commission 5% on \$2,513.40	<u>125.67</u>
		<u>\$ 178.67</u>

DISTRIBUTIONS OF INCOME TO BENEFICIARIES

11/16/79	TO: William C. Doe, Trustee under Article FOURTH (A) for Walter Doe Cash	\$ 1,167.37
11/16/79	TO: Sharon Doe Cash	<u>1,167.36</u>
	Total	<u>\$ 2,334.73</u>

PROPOSED DISTRIBUTIONS TO BENEFICIARIES

	Current Value 12/10/79 or as noted	Fiduciary Acquisition Value
Per Article FOURTH (A) of Will:		
TO: William C. Doe, Trustee for Walter Doe		
25 shs. Best Oil Co., common	\$ 2,250.00	\$ 2,500.00
500 shs. Central Trust Co., capital	16,084.38*	12,712.50
58 shs. Electric Data Corp., common	842.00*	725.00
25 shs. Fabulous Mutual Fund	2,008.09	916.67
100 shs. Home Telephone & Telegraph Co., common	8,000.00	6,250.00
\$20,000 U.S. Treasury Bills, due 12/14/79	19,650.00	19,650.00
Cash	<u>2,652.81</u>	<u>2,652.81</u>
	\$ 51,487.28	\$ 45,406.98
Per Article FOURTH (B) of Will:		
TO: Sharon Doe		
25 shs. Best Oil Co., common	\$ 2,250.00	\$ 2,500.00
500 shs. Central Trust Co., capital	16,084.38*	12,712.50
58 shs. Electric Data Corp., common	842.00*	725.00
25 shs. Fabulous Mutual Fund	2,008.09	916.67
100 shs. Home Telephone & Telegraph Co., common	8,000.00	6,250.00
\$20,000 U.S. Treasury Bills, due 12/14/79	19,650.00	19,650.00
Cash	<u>2,652.81</u>	<u>2,652.81</u>
	\$ 51,487.28	\$ 45,406.98
Total	<u>\$ 102,974.56</u>	<u>\$ 90,813.96</u>

*Central Trust Co. — valued at most recent sale, 9/18/79

*Electric Data Corp. — not traded, valued per company books 12/29/78

WILLIAM C. DOE, Executor under the Last Will and Testament of JOHN DOE, deceased, hereby declares under oath [penalties of perjury] that he has fully and faithfully discharged the duties of his office; that the foregoing First and Final Account is true and correct and fully discloses all significant transactions occurring during the accounting period; that all known claims against the estate have been paid in full; that, to his knowledge, there are no claims now outstanding against the Estate; and that all taxes presently due from the estate have been paid.

WILLIAM C. DOE
Executor

Subscribed and sworn to
by WILLIAM C. DOE before
me this _____ day of _____, 19____.

Notary Public

Appendix G:
1987 U.S. Fiduciary Income Tax Return.⁷

7. Proof copy, as of August 5, 1987; final version not available from the Government Printing Office as of the date of issuance of this report.

U.S. Fiduciary Income Tax Return
 For the calendar year 1987 or fiscal year

OMB No. 1545-0092

1987

Check applicable boxes: <input type="checkbox"/> Decedent's estate <input type="checkbox"/> Simple trust <input type="checkbox"/> Complex trust <input type="checkbox"/> Grantor type trust <input type="checkbox"/> Bankruptcy estate <input type="checkbox"/> Family estate trust <input type="checkbox"/> Pooled income fund <input type="checkbox"/> Initial return <input type="checkbox"/> Amended return <input type="checkbox"/> Final return	beginning 1987 and ending 19	Employer identification number
	Name of estate or trust (grantor type trust, see instructions)	Date entity created
	Name and title of fiduciary	Nonexempt charitable and split-interest trusts, check applicable boxes (see instructions): <input type="checkbox"/> Described in section 4947(a)(1) <input type="checkbox"/> Not a private foundation <input type="checkbox"/> Described in section 4947(a)(2)
	Address of fiduciary (number and street)	
	City, state, and ZIP code	
Check if this return is for a short taxable year (see instructions) <input type="checkbox"/>		

Income	1 Dividends	1	
	2 Interest income	2	
	3 Income (or losses) from partnerships, other estates or other trusts (see instructions)	3	
	4 Net rent and royalty income (or loss) (attach Schedule E (Form 1040))	4	
	5 Net business and farm income (or loss) (attach Schedules C and F (Form 1040))	5	
	6 Capital gain (or loss) (attach Schedule D (Form 1041))	6	
	7 Ordinary gain (or loss) (attach Form 4797)	7	
	8 Other income (state nature of income)	8	
	9 Total income (add lines 1 through 8)	9	
Deductions	10 Interest	10	
	11 Fiduciary fees	11	
	12 Charitable deduction (from Schedule A, line 6)	12	
	13 Attorney, accountant, and return preparer fees	13	
	14 Other deductions (including taxes) (attach schedule)	14	
	15 Total (add lines 10 through 14)	15	
	16 Adjusted total income (or loss) (subtract line 15 from line 9)	16	
	17 Income distribution deduction (from Schedule B, line 17) (see instructions) (attach Schedule K-1 (Form 1041))	17	
	18 Estate tax deduction (attach computation)	18	
	19 Exemption	19	
	20 Total (add lines 17 through 19)	20	
21 Taxable income of fiduciary (subtract line 20 from line 16)	21		
Please attach check or money order here Compute amount of tax	22 Tax: <input type="checkbox"/> a Tax rate schedule or <input checked="" type="checkbox"/> Schedule D <input type="checkbox"/> b Other tax	22c	
	23 Credits: a Foreign tax b Nonconventional fuel	23c	
	24 Credits: <input type="checkbox"/> Form 3800 <input type="checkbox"/> Form 3468 <input type="checkbox"/> Form 5884 <input type="checkbox"/> Form 5478 <input type="checkbox"/> Form 6765 <input type="checkbox"/> Form 8586	24	
	25 Total (add lines 23c and 24)	25	
	26 Balance (subtract line 25 from line 22c)	26	
	27 Recapture of investment credit (attach Form 4255)	27	
	28 Alternative minimum tax (attach Form 8656)	28	
	29 Total (add lines 26 through 28)	29	
	30 Credits: a Form 2439 b Form 4136 c Form 6249	30d	
	31 Payments: a 1987 estimated tax payments b Paid with extension of time to file (attach Form 2255) c Withheld	31d	
	32 Total (add lines 30d and 31d)	32	
	33 Balance of tax due (subtract line 32 from line 29) (see instructions)	33	
	34 Overpayment (subtract line 29 from line 32)	34	
	35 Amount of line 34 to be: a Credited to 1988 estimated taxes b Treated as paid by trust beneficiaries (Attach Form 1041-T) c Refunded	35c	

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 fiduciary) is based on all information of which preparer has any knowledge.

Signature of fiduciary or officer representing fiduciary	Date
Preparer's signature	Date
Preparer's name (or yours if self-employed) and address	Preparer's social security no.
	Check if self-employed <input type="checkbox"/>
	EI No
	ZIP code

Do not complete Schedules A and B for a simple trust or a pooled income fund.

SCHEDULE A.—Charitable Deduction

(Write the name and address of each charitable organization to whom your contributions total \$3,000 or more on an attached sheet.)

1 Amounts paid or permanently set aside for charitable purposes from current year's gross income	1	
2 Tax-exempt interest allocable to charitable distribution (see instructions)	2	
3 Balance (subtract line 2 from line 1)	3	
4 Enter the net short-term capital gain and the net long-term capital gain of the current year allocable to corpus paid or permanently set aside for charitable purposes	4	
5 Amounts paid or permanently set aside for charitable purposes from gross income of a prior year (see instructions)	5	
6 Total (add lines 3, 4, and 5). Enter here and on page 1, line 12	6	

SCHEDULE B.—Income Distribution Deduction

1 Adjusted total income (Enter amount from page 1, line 16.) (If net loss, enter zero.)	1	
2 Adjusted tax-exempt interest (see instructions)	2	
3 Net gain shown on Schedule D (Form 1041), line 17, column (a) (If net loss, enter zero.)	3	
4 Enter amount from Schedule A, line 4	4	
5 Long-term capital gain included on Schedule A, line 1	5	
6 Short-term capital gain included on Schedule A, line 1	6	
7 If the amount on page 1, line 6, is a capital loss, enter here as a positive figure	7	
8 If the amount on page 1, line 6, is a capital gain, enter here as a negative figure	8	
9 Distributable net income (combine lines 1 through 8)	9	
10 If a complex trust, amount of income for the tax year determined under the governing instrument (accounting income)	10	
11 Amount of income required to be distributed currently (see instructions)	11	
12 Other amounts paid, credited, or otherwise required to be distributed (see instructions)	12	
13 Total distributions (add lines 11 and 12). (If greater than line 10, see instructions.)	13	
14 Enter the total amount of tax-exempt income included on line 13	14	
15 Tentative income distribution deduction (subtract line 14 from line 13)	15	
16 Tentative income distribution deduction (subtract line 2 from line 9)	16	
17 Income distribution deduction (Enter the smaller of line 15 or line 16 here and on page 1, line 17.)	17	

Other Information

	Yes	No
1 If the fiduciary's name or address has changed, enter the old information ▶		
2 Did the estate or trust receive tax-exempt income? (If "Yes," enter the amount here ▶ and attach a computation of the allocation of expenses.)		
3 Did the estate or trust have any passive activity income or loss? (If "Yes," enter the amount of any such income or loss on Form 8582, Passive Activity Loss Limitations, to figure the allowable loss.)		
4 Did the estate or trust receive all or any part of the earnings (salary, wages, and other compensation) of any individual by reason of a contract assignment or similar arrangement?		
5 At any time during the tax year, did the estate or trust have an interest in or a signature or other authority over a financial account in a foreign country (such as a bank account, securities account, or other financial account)? (See the instructions for question 5.) If "Yes," enter the name of the foreign country ▶		
6 Was the estate or trust the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not the estate or trust has any beneficial interest in it? (If "Yes," you may have to file Form 3520, 3520-A, or 926.)		
7 Check this box if this entity has filed or is required to file Form 8264, Application for Registration of a Tax Shelter. ▶ <input type="checkbox"/>		
8 Check this box if this entity is a complex trust making the section 663(b) election ▶ <input type="checkbox"/>		
9 Check this box if a section 643(e)(3) election is made (attach Schedule D (Form 1041)) ▶ <input type="checkbox"/>		
10 Check this box if the decedent's estate has been open for more than 2 years (see instructions) ▶ <input type="checkbox"/>		

SCHEDULE K-1
(Form 1041)

Beneficiary's Share of Income, Deductions, Credits, etc.—1987
for the calendar year 1987, or fiscal year

OMB No 1545-0092

beginning 1987, ending 19

1987

Department of the Treasury
Internal Revenue Service

Complete a separate Schedule K-1 for each beneficiary

Name of estate or trust ▶

Beneficiary's identifying number ▶

Estate or trust's employer identification number ▶

Beneficiary's name, address, and ZIP code

Fiduciary's name, address, and ZIP code

A. 4-Year Proration.—Fiduciary: Check here if this Schedule K-1 is for a short taxable year required by section 1403 of the Tax Reform Act of 1986. Beneficiary: If this box is checked, you must prorate the column (b) amounts (except for line 9a) shown below over a four year period beginning with this tax year. (See the instructions on the other side of this schedule.)

(a) Allocable share item	(b) Amount	(c) Calendar year 1987 Form 1040 filers enter the amounts in column (b) on
1 Dividends		Schedule B, Part II, line 4
2a Net short-term capital gain (or loss)		Schedule D, line 5, column (f) or (g)
b Net long-term capital gain (or loss)		Schedule D, line 12, column (f) or (g)
3 Interest		Schedule B, Part I, line 2
4a Other taxable income (itemize):		
(1) Income (or loss) from passive activities acquired before 10/23/86		Form 8582
(2) Income (or loss) from passive activities acquired after 10/22/86		Form 8582
(3) Other portfolio income (or loss)		Schedule E, Part III
b Depreciation (including cost recovery) and depletion:		
(1) Attributable to line 4a(1)		Form 8582
(2) Attributable to line 4a(2)		Form 8582
(3) Attributable to line 4a(3)		Schedule E, Part III
c Amortization deductions (itemize):		
(1) Attributable to line 4a(1)		Form 8582
(2) Attributable to line 4a(2)		Form 8582
(3) Attributable to line 4a(3)		Schedule E, Part III
5 Estate tax deduction (attach computation)		Schedule A, line 25
6 Excess deductions on termination (attach computation)		Schedule A, line 21
7 Distributable Net Alternative Minimum Taxable Income		Enter on applicable line of Form 6251
8 Foreign taxes (list on a separate sheet)		Form 1041 or Schedule K-1 Form 1041, line 7
9 Other (itemize):		
a Trust payments of estimated taxes credited to you		Include on Page 2, line 55, Form 1041
b Tax-exempt interest		Enter on Page 1, line 9
c		
d		
e		(Enter on applicable line of appropriate tax form)
f		
g		
h		

For Paperwork Reduction Act Notice, see page 1 of the instructions for Form 1041.

Schedule K-1 (Form 1041) 1987

Appendix H:
The Internal Revenue Code of 1986.⁸

[REDACTED]

8. Code Sections 641 - 692, pertaining to estates, from the 1986 code as amended through P.L. 99-514.

ESTATES • TRUSTS • BENEFICIARIES

IMPOSITION OF TAX

Sec. 641 [1986 Code]. (a) APPLICATION OF TAX.—The tax imposed by section 1(e) shall apply to the taxable income of estates or of any kind of property held in trust, including—

(1) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) COMPUTATION AND PAYMENT.—The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary.

(c) EXCLUSION OF INCLUDIBLE GAIN FROM TAXABLE INCOME.—

(1) GENERAL RULE.—For purposes of this part, the taxable income of a trust does not include the amount of any includible gain as defined in section 644(b) reduced by any deductions properly allocable thereto.

(2) CROSS REFERENCE.—

For the taxation of any includible gain, see section 644.

SPECIAL RULES FOR CREDITS AND DEDUCTIONS

Sec. 642 [1986 Code]. (a) CREDITS AGAINST TAX.—

(1) FOREIGN TAXES.—An estate or trust shall be allowed the credit against tax for taxes imposed by foreign countries and possessions of the United States, to the extent allowed by section 901, only in respect of so much of the taxes described in such section as is not properly allocable under such section to the beneficiaries.

(2) POLITICAL CONTRIBUTION.—An estate or trust shall not be allowed the credit against tax for political contributions provided by section 24.

(a) FOREIGN TAX CREDIT ALLOWED.—An estate or trust shall be allowed the credit against tax for taxes imposed by foreign countries and possessions of the United States, to the extent allowed by section 901, only in respect of so much of the taxes described in such section as is not properly allocable under such section to the beneficiaries.

(b) DEDUCTION FOR PERSONAL EXEMPTION.—An estate shall be allowed a deduction of \$600. A trust which, under its governing instrument, is required to distribute all of its income currently shall be allowed a deduction of \$300. All other trusts shall be allowed a deduction of \$100. The deductions allowed by this subsection shall be in lieu of the deductions allowed under section 151 (relating to deduction for personal exemption).

(c) DEDUCTION FOR AMOUNTS PAID OR PERMANENTLY SET ASIDE FOR A CHARITABLE PURPOSE.—

(1) GENERAL RULE.—In the case of an estate or trust (other than a trust meeting the specifications of subpart B), there shall be allowed as a deduction in computing its taxable income (in lieu of the deduction allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid for a purpose specified in section 170(c) (determined without regard to section 170(c)(2)(A)). If a charitable contribution is paid after the close of such taxable year and on or before the last day of the year following the close of such taxable year, then the trustee or administrator may elect to treat such contribution as paid during such taxable year. The election shall be made at such time and in such manner as the Secretary prescribes by regulations.

(2) AMOUNTS PERMANENTLY SET ASIDE.—In the case of an estate, and in the case of a trust (other than a trust meeting the specifications of subpart B) required by the terms of its governing instrument to set aside amounts which was—

(A) created on or before October 9, 1969, if—

(i) an irrevocable remainder interest is transferred to or for the use of an organization described in section 170(c), or

(ii) the grantor is at all times after October 9, 1969, under a mental disability to change the terms of the trust; or

(B) established by a will executed on or before October 9, 1969, if—

(i) the testator dies before October 9, 1972, without having republished the will after October 9, 1969, by codicil or otherwise,

(ii) the testator at no time after October 9, 1969, had the right to change the portions of the will which pertain to the trust, or

(iii) the will is not republished by codicil or otherwise before October 9, 1972, and the testator is on such date and at all times thereafter under a mental disability to republish the will by codicil or otherwise,

there shall also be allowed as a deduction in computing its taxable income any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance, or operation of a public cemetery not operated for profit. In the case of a trust, the preceding sentence shall apply only to gross income earned with respect to amounts transferred to the trust before October 9, 1969, or transferred under a will to which subparagraph (B) applies.

(3) POOLED INCOME FUNDS.—In the case of a pooled income fund (as defined in paragraph (5)), there shall be allowed as a deduction in computing its taxable income any amount of the gross income attributable to gain from the sale of a capital asset held for more than 6 months, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, permanently set aside for a purpose specified in section 170(c).

(4) ADJUSTMENTS.—To the extent that the amount otherwise allowable as a deduction under this subsection consists of gain from the sale or exchange of capital assets held for more than 6 months, proper adjustment shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses). In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income).

(4) COORDINATION WITH SECTION 681.—In the case of a trust, the deduction allowed by this subsection shall be subject to section 681 (relating to unrelated business income).

(5) DEFINITION OF POOLED INCOME FUND.—For purposes of paragraph (3), a pooled income fund is a trust—

(A) to which each donor transfers property, contributing an irrevocable remainder interest in such property to or for the use of an organization described in section 170(b)(1)(A) (other than in clauses (vii) or (viii)), and retaining an income interest for the life of one or more beneficiaries (living at the time of such transfer),

(B) in which the property transferred by each donor is commingled with property transferred by other donors who have made or make similar transfers,

(C) which cannot have investments in securities which are exempt from the taxes imposed by this subtitle,

(D) which includes only amounts received from transfers which meet the requirements of this paragraph,

(E) which is maintained by the organization to which the remainder interest is contributed and of which no donor or beneficiary of an income interest is a trustee, and

(F) from which each beneficiary of an income interest receives income, for each year for which he is entitled to receive the income interest referred to in subparagraph (A), determined by the rate of return earned by the trust for such year.

For purposes of determining the amount of any charitable contribution allowable by reason of a transfer of property to a pooled fund, the value of the income interest shall be determined on the basis of the highest rate of return earned by the fund for any of the 3 taxable years immediately preceding the taxable year of the fund in which the transfer is made. In the case of funds in existence less than 3 taxable years preceding the taxable year of the fund in which a transfer is made, the rate of return shall be deemed to be 6 percent per annum, except that the Secretary may prescribe a different rate of return.

(6) **TAXABLE PRIVATE FOUNDATIONS.**—In the case of a private foundation which is not exempt from taxation under section 501(a) for the taxable year, the provisions of this subsection shall not apply and the provisions of section 170 shall apply.

(d) **NET OPERATING LOSS DEDUCTION.**—The benefit of the deduction for net operating losses provided by section 172 shall be allowed to estates and trusts under regulations prescribed by the Secretary.

(e) **DEDUCTION FOR DEPRECIATION AND DEPLETION.**—An estate or trust shall be allowed the deduction for depreciation and depletion only to the extent not allowable to beneficiaries under sections 167(h) and 611(b).

(f) **AMORTIZATION DEDUCTIONS.**—The benefit of the deductions for amortization provided by sections 169, 184, 187, and 188 shall be allowed to estates and trusts in the same manner as in the case of an individual. The allowable deduction shall be apportioned between the income beneficiaries and the fiduciary under regulations prescribed by the Secretary.

(g) **DISALLOWANCE OF DOUBLE DEDUCTIONS.**—Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction (or as an offset against the sales price of property in determining gain or loss) in computing the taxable income of the estate or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054. This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of decedents).

(h) **UNUSED LOSS CARRYOVERS AND EXCESS DEDUCTIONS ON TERMINATION AVAILABLE TO BENEFICIARIES.**—If on the termination of an estate or trust, the estate or trust has—

(1) a net operating loss carryover under section 172 or a capital loss carryover under section 1212, or

(2) for the last taxable year of the estate or trust deductions (other than the deductions allowed under subsection (b) or (c)) in excess of gross income for such year,

then such carryover or such excess shall be allowed as a deduction, in accordance with regulations prescribed by the Secretary, to the beneficiaries succeeding to the property of the estate or trust.

(i) **CERTAIN DISTRIBUTIONS BY CEMETERY PERPETUAL CARE FUNDS.**—In the case of a cemetery perpetual care fund which—

(1) was created pursuant to local law by a taxable cemetery corporation for the care and maintenance of cemetery property, and

(2) is treated for the taxable year as a trust for purposes of this subchapter,

any amount distributed by such fund for the care and maintenance of gravesites which have been purchased from the cemetery corporation before the beginning of the taxable year of the trust and with respect to which there is an obligation to furnish care and maintenance shall be considered to be a distribution solely for purposes of sections 651 and 661, but only to the extent that the aggregate amount so distributed during the taxable year does not exceed \$5 multiplied by the aggregate number of such gravesites.

(j) **CROSS REFERENCES.**—

For special rule for determining the time of receipt of dividends by a beneficiary under section 652 or 662, see section 116(c)(3).

DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D

Sec. 643 [1986 Code]. (a) **DISTRIBUTABLE NET INCOME.**—For purposes of this part the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

(1) **DEDUCTION FOR DISTRIBUTIONS.**—No deduction shall be taken under sections 651 and 661 (relating to additional deductions).

(2) **DEDUCTION FOR PERSONAL EXEMPTION.**—No deduction shall be taken under section 642(b) (relating to deduction for personal exemptions).

(3) CAPITAL GAINS AND LOSSES.—Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year, or (B) paid, permanently set aside, or to be used for the purposes specified in section 642(c). Losses from the sale or exchange of capital assets shall be excluded, except to the extent such losses are taken into account in determining the amount of gains from the sale or exchange of capital assets which are paid, credited, or required to be distributed to any beneficiary during the taxable year. The deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(4) EXTRAORDINARY DIVIDENDS AND TAXABLE STOCK DIVIDENDS.—For purposes only of subpart B (relating to trusts which distribute current income only), there shall be excluded those items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, does not pay or credit to any beneficiary by reason of his determination that such dividends are allocable to corpus under the terms of the governing instrument and applicable local law.

(5) TAX-EXEMPT INTEREST.—There shall be included any tax-exempt interest to which section 103 applies, reduced by any amounts which would be deductible in respect of disbursements allocable to such interest but for the provisions of section 265 (relating to disallowance of certain deductions).

(6) INCOME OF FOREIGN TRUST.—In the case of a foreign trust—

(A) There shall be included the amounts of gross income from sources without the United States, reduced by any amounts which would be deductible in respect of disbursements allocable to such income but for the provisions of section 265(1) (relating to disallowance of certain deductions).

(B) Gross income from sources within the United States shall be determined without regard to section 894 (relating to income exempt under treaty).

(C) Paragraph (3) shall not apply to a foreign trust. In the case of such a trust, (i) there shall be included gains from the sale or exchange of capital assets, reduced by losses from such sales or exchanges to the extent such losses do not exceed gains from such sales or exchanges, and (ii) the deduction under section 1202 (relating to deduction for excess of capital gains over capital losses) shall not be taken into account.

(D) Effective for distributions made in taxable years beginning after December 31, 1975, the undistributed net income of each foreign trust for each taxable year beginning on or before December 31, 1975, remaining undistributed at the close of the last taxable year beginning on or before December 31, 1975, shall be redetermined by taking into account the deduction allowed by section 1202.

(7) DIVIDENDS OR INTEREST.—There shall be included the amount of any dividends or interest excluded from gross income pursuant to section 116 (relating to partial exclusion of dividends) or section 128 (relating to certain interest).

If the estate or trust is allowed a deduction under section 642(c), the amount of the modifications specified in paragraphs (5) and (6) shall be reduced to the extent that the amount of income which is paid, permanently set aside, or to be used for the purposes specified in section 642(c) is deemed to consist of items specified in those paragraphs. For this purpose, such amount shall (in the absence of specific provisions in the governing instrument) be deemed to consist of the same proportion of each class of items of income of the estate or trust as the total of each class bears to the total of all classes.

(b) INCOME.—For purposes of this subpart and subparts B, C, and D, the term “income”, when not preceded by the words “taxable”, “distributable net”, “undistributed net”, or “gross”, means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law shall not be considered income.

(c) BENEFICIARY.—For purposes of this part, the term “beneficiary” includes heir, legatee, devisee.

(d) COORDINATION WITH BACK-UP WITHHOLDING.—Except to the extent otherwise provided in regulations, this subchapter shall be applied with respect to payments subject to withholding under section 3406—

(1) by allocating between the estate or trust and its beneficiaries any credit allowable under section 31(c) (on the basis of their respective shares of any such payment taken into account under this subchapter),

(2) by treating each beneficiary to whom such credit is allocated as if an amount equal to such credit has been paid to him by the estate or trust, and

(3) by allowing the estate or trust a deduction in an amount equal to the credit so allocated to beneficiaries.

(e) TREATMENT OF PROPERTY DISTRIBUTED IN KIND.—

(1) BASIS OF BENEFICIARY.—The basis of any property received by a beneficiary in a distribution from an estate or trust shall be—

(A) the adjusted basis of such property in the hands of the estate or trust immediately before the distribution, adjusted for

(B) any gain or loss recognized to the estate or trust on the distribution.

(2) AMOUNT OF DISTRIBUTION.—In the case of any distribution of property (other than cash), the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the lesser of—

(A) the basis of such property in the hands of the beneficiary (as determined under paragraph (1)), or

(B) the fair market value of such property.

(3) ELECTION TO RECOGNIZE GAIN.—

(A) IN GENERAL.—In the case of any distribution of property (other than cash) to which an election under this paragraph applies—

(i) paragraph (2) shall not apply,

(ii) gain or loss shall be recognized by the estate or trust in the same manner as if such property had been sold to the distributee at its fair market value, and

(iii) the amount taken into account under sections 661(a)(2) and 662(a)(2) shall be the fair market value of such property.

(B) ELECTION.—Any election under this paragraph shall apply to all distributions made by the estate or trust during a taxable year and shall be made on the return of such estate or trust for such taxable year.

Any such election, once made, may be revoked only with the consent of the Secretary.

(4) EXCEPTION FOR DISTRIBUTIONS DESCRIBED IN SECTION 663(a).—This subsection shall not apply to any distribution described in section 663(a).

(f) TREATMENT OF MULTIPLE TRUSTS.—For purposes of this subchapter, under regulations prescribed by the Secretary, 2 or more trusts shall be treated as 1 trust if—

(1) such trusts have substantially the same grantor or grantors and substantially the same primary beneficiary or beneficiaries, and

(2) a principal purpose of such trusts is the avoidance of the tax imposed by this chapter.

For purposes of the preceding sentence, a husband and wife shall be treated as 1 person.

(g) CERTAIN PAYMENTS OF ESTIMATED TAX TREATED AS PAID BY BENEFICIARY.—

(1) IN GENERAL.—In the case of a trust—

(A) the trustee may elect to treat any portion of a payment of estimated tax made by such trust for any taxable year of the trust as a payment made by a beneficiary of such trust,

(B) any amount so treated shall be treated as paid or credited to the beneficiary on the last day of such taxable year, and

(C) for purposes of subtitle F, the amount so treated—

(i) shall not be treated as a payment of estimated tax made by the trust, but

(ii) shall be treated as a payment of estimated tax made by such beneficiary on January 15 following the taxable year.

The preceding sentence shall apply only to the extent the payments of estimated tax made by the trust for the taxable year exceed the tax imposed by this chapter shown on its return for the taxable year.

(2) TIME FOR MAKING ELECTION.—An election under paragraph (1) may be made—

(A) only on the trust's return of the tax imposed by this chapter for the taxable year, and

(B) only if such return is filed on or before the 65th day after the close of the taxable year.

SPECIAL RULE FOR GAIN ON PROPERTY TRANSFERRED TO TRUST AT LESS THAN FAIR MARKET VALUE

Sec. 644 [1986 Code]. (a) IMPOSITION OF TAX.—

(1) IN GENERAL.—If—

(A) a trust (or another trust to which the property is distributed sells or exchanges property at a gain not more than 2 years after the date of the initial transfer of the property in trust by the transferor, and

(B) the fair market value of such property at the time of the initial transfer in trust by the transferor exceeds the adjusted basis of such property immediately after such transfer,

there is hereby imposed a tax determined in accordance with paragraph (2) on the includible gain recognized on such sale or exchange.

(2) AMOUNT OF TAX.—The amount of the tax imposed by paragraph (1) on any includible gain recognized on the sale or exchange of any property shall be equal to the sum of—

(A) the excess of—

(i) the tax which would have been imposed under this chapter for the taxable year of the transferor in which the sale or exchange of such property occurs had the amount of the includible gain recognized on such sale or exchange, reduced by any deductions properly allocable to such gain, been included in the gross income of the transferor for such taxable year, over

(ii) the tax actually imposed under this chapter for such taxable year on the transferor, plus

(B) if such sale or exchange occurs in a taxable year of the transferor which begins after the beginning of the taxable year of the trust in which such sale or exchange occurs, an amount equal to the amount determined under subparagraph (A) multiplied by the underpayment rate established under section 6621.

The determination of tax under clause (i) of subparagraph (A) shall be made by not taking into account any carryback, and by not taking into account any loss deduction to the extent that such loss or deduction may be carried by the transferor to any other taxable year.

(3) TAXABLE YEAR FOR WHICH TAX IMPOSED.—The tax imposed by paragraph (1) shall be imposed for the taxable year of the trust which begins with or within the taxable year of the transferor in which the sale or exchange occurs.

(4) TAX TO BE IN ADDITION TO OTHER TAXES.—The tax imposed by this subsection for any taxable year of the trust shall be in addition to any other tax imposed by this chapter for such taxable year.

(b) DEFINITION OF INCLUDIBLE GAIN.—For purposes of this section, the term "includible gain" means the lesser of—

(1) the gain recognized by the trust on the sale or exchange of any property, or

(2) the excess of the fair market value of such property at the time of the initial transfer in trust by the transferor over the adjusted basis of such property immediately after such transfer.

(c) CHARACTER OF INCLUDIBLE GAIN.—For purposes of subsection (a)—

(1) the character of the includible gain shall be determined as if the property had actually been sold or exchanged by the transferor, and any activities of the trust with respect to the sale or exchange of the property shall be deemed to be activities of the transferor, and

(2) the portion of the includible gain subject to the provisions of section 1245 and section 1250 shall be determined in accordance with regulations prescribed by the Secretary.

(d) SPECIAL RULES.—

(1) SHORT SALES.—If the trust sells the property referred to in subsection (a) in a short sale within the 2-year period referred to in such subsection, such 2-year period shall be extended to the date of the closing of such short sale.

(2) SUBSTITUTED BASIS PROPERTY.—For purposes of this section, in the case of any property held by the trust which has a basis determined in whole or in part by reference to the basis of any other property which was transferred to the trust—

(A) the initial transfer of such property in trust by the transferor shall be treated as having occurred on the date of the initial transfer in trust of such other property,

(B) subsections (a)(1)(B) and (b)(2) shall be applied by taking into account the fair market value and the adjusted basis of such other property, and

(C) the amount determined under subsection (b)(2) with respect to such other property shall be allocated (under regulations prescribed by the Secretary) among

such other property and all properties held by the trust which have a basis determined in whole or in part by reference to the basis of such other property.

(e) EXCEPTIONS.—Subsection (a) shall not apply to property—

(1) acquired by the trust from a decedent or which passed to a trust from a decedent (within the meaning of section 1014), or

(2) acquired by a pooled income fund (as defined in section 642(c)(5)), or

(3) acquired by a charitable remainder annuity trust (as defined in section 664(d)(1)) or a charitable remainder unitrust (as defined in sections 664(d)(2) and (3)), or

(4) if the sale or exchange of the property occurred after the death of the transferor.

(f) SPECIAL RULE FOR INSTALLMENT SALES.—If the trust reports income under section 453 on any sale or exchange to which subsection (a) applies, under regulations prescribed by the Secretary—

(1) subsection (a) (other than the 2-year requirement of paragraph (1)(A) thereof) shall be applied as if each installment were a separate sale or exchange of property to which such subsection applies, and

(2) the term "includible gain" shall not include any portion of an installment received by the trust after the death of the transferor.

TAXABLE YEAR OF TRUSTS

Sec. 645 [1986 Code]. (a) IN GENERAL.—For purposes of this subtitle, the taxable year of any trust shall be the calendar year.

(b) EXCEPTION FOR TRUSTS EXEMPT FROM TAX AND CHARITABLE TRUSTS.—Subsection (a) shall not apply to a trust exempt from taxation under section 501(a) or to a trust described in section 4947(a)(1).

DEDUCTION FOR TRUSTS DISTRIBUTING CURRENT INCOME ONLY

Sec. 651 [1986 Code]. (a) DEDUCTION.—In the case of any trust the terms of which—

(1) provide that all of its income is required to be distributed currently, and

(2) do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in section 642(c) (relating to deduction for charitable, etc., purposes),

there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed currently. This section shall not apply in any taxable year in which the trust distributes amounts other than amounts of income described in paragraph (1).

(b) LIMITATION ON DEDUCTION.—If the amount of income required to be distributed currently exceeds the distributable net income of the trust for the taxable year, the deduction shall be limited to the amount of the distributable net income. For this purpose, the computation of distributable net income shall not include items of income which are not included in the gross income of the trust and the deductions allocable thereto.

BENEFICIARIES

INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF TRUSTS DISTRIBUTING CURRENT INCOME ONLY

Sec. 652 [1986 Code]. (a) **INCLUSION.**—Subject to subsection (b), the amount of income for the taxable year required to be distributed currently by a trust described in section 651 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. If such amount exceeds the distributable net income, there shall be included in the gross income of each beneficiary an amount which bears the same ratio to distributable net income as the amount of income required to be distributed to such beneficiary bears to the amount of income required to be distributed to all beneficiaries.

(b) **CHARACTER OF AMOUNTS.**—The amounts specified in subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income of the trust as the total of each class bears to the total distributable net income of the trust, unless the terms of the trust specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary.

(c) **DIFFERENT TAXABLE YEARS.**—If the taxable year of a beneficiary is different from that of the trust, the amount which the beneficiary is required to include in gross income in accordance with the provisions of this section shall be based upon the amount of income of the trust for any taxable year or years of the trust ending within or with his taxable year.

DEDUCTION FOR ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS

Sec. 661 [1986 Code]. (a) **DEDUCTION.**—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

(b) **CHARACTER OF AMOUNTS DISTRIBUTED.**—The amount determined under subsection (a) shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income of the estate or trust as the total of each class bears to the total distributable net income of the estate or trust in the absence of the allocation of different classes of income under the specific terms of the governing instrument. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 642(c)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary.

(c) **LIMITATION ON DEDUCTION.**—No deduction shall be allowed under subsection (a) in respect of any portion of the amount allowed as a deduction under that subsection (without regard to this subsection) which is treated under subsection (b) as consisting of any item of distributable net income which is not included in the gross income of the estate or trust.

INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS

Sec. 662 [1986 Code]. (a) **INCLUSION.**—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661(a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) AMOUNTS REQUIRED TO BE DISTRIBUTED CURRENTLY.—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. If the amount of income required to be distributed currently to all beneficiaries exceeds the distributable net income (computed without the deduction allowed by section 642(c), relating to deduction for charitable, etc. purposes) of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (as so computed) as the amount of income required to be distributed currently to such beneficiary bears to the amount required to be distributed currently to all beneficiaries. For purposes of this section, the phrase "the amount of income for the taxable year required to be distributed currently" includes any amount required to be paid out of income or corpus to the extent such amount is paid out of income for such taxable year.

(2) OTHER AMOUNTS DISTRIBUTED.—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. If the sum of—

(A) the amount of income for the taxable year required to be distributed currently to all beneficiaries, and

(B) all other amounts properly paid, credited, or required to be distributed to all beneficiaries,

exceeds the distributable net income of the estate or trust, then, in lieu of the amount provided in the preceding sentence, there shall be included in the gross income of the beneficiary an amount which bears the same ratio to distributable net income (reduced by the amounts specified in (A)) as the other amounts properly paid, credited or required to be distributed to the beneficiary bear to the other amounts properly paid, credited, or required to be distributed to all beneficiaries.

(b) CHARACTER OF AMOUNTS.—The amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. For this purpose, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income of the estate or trust unless the terms of the governing instrument specifically allocate different classes of income to different beneficiaries. In the application of the preceding sentence, the items of deduction entering into the computation of distributable net income (including the deduction allowed under section 642(c)) shall be allocated among the items of distributable net income in accordance with regulations prescribed by the Secretary. In the application of this subsection to the amount determined under paragraph (1) of subsection (a), distributable net income shall be computed without regard to any portion of the deduction under section 642(c) which is not attributable to income of the taxable year.

(c) DIFFERENT TAXABLE YEARS.—If the taxable year of a beneficiary is different from that of the estate or trust, the amount to be included in the gross income of the beneficiary shall be based on the distributable net income of the estate or trust and the amounts properly paid, credited, or required to be distributed to the beneficiary during any taxable year or years of the estate or trust ending within or with his taxable year.

SPECIAL RULES APPLICABLE TO SECTIONS 661 AND 662

Sec. 663 [1986 Code]. (a) EXCLUSIONS.—There shall not be included as amounts falling within section 661(a) or 662(a)—

(1) GIFTS, BEQUESTS, ETC.—Any amount which, under the terms of the governing instrument, is properly paid or credited as a gift or bequest of a specific sum of money or of specific property and which is paid or credited all at once or in not more than 3 installments. For this purpose an amount which can be paid or credited only from the income of the estate or trust shall not be considered as a gift or bequest of a specific sum of money.

(2) CHARITABLE, ETC., DISTRIBUTIONS.—Any amount paid or permanently set aside or otherwise qualifying for the deduction provided in section 642(c) (computed without regard to sections 508(d), 681, and 4948(c)(4)).

(3) DENIAL OF DOUBLE DEDUCTION.—Any amount paid, credited, or distributed in the taxable year, if section 651 or section 661 applied to such amount for a preceding taxable year of an estate or trust because credited or required to be distributed in such preceding taxable year.

(b) DISTRIBUTIONS IN FIRST SIXTY-FIVE DAYS OF TAXABLE YEAR.—

(1) GENERAL RULE.—If within the first 65 days of any taxable year of a trust, an amount is properly paid or credited, such amount shall be considered paid or credited on the last day of the preceding taxable year.

(2) LIMITATION.—Paragraph (1) shall apply with respect to any taxable year of a trust only if the fiduciary of such trust elects, in such manner and at such time as the Secretary prescribes by regulations, to have paragraph (1) apply for such taxable year.

(c) SEPARATE SHARES TREATED AS SEPARATE TRUSTS.—For the sole purpose of determining the amount of distributable net income in the application of sections 661 and 662, in the case of a single trust having more than one beneficiary, substantially separate and independent shares of different beneficiaries in the trust shall be treated as separate trusts. The existence of such substantially separate and independent shares and the manner of treatment as separate trusts, including the application of subpart D, shall be determined in accordance with regulations prescribed by the Secretary.

CHARITABLE REMAINDER TRUSTS

Sec. 664 [1986 Code]. (a) GENERAL RULE.—Notwithstanding any other provision of this subchapter, the provisions of this section shall, in accordance with regulations prescribed by the Secretary, apply in the case of a charitable remainder annuity trust and a charitable remainder unitrust.

(b) CHARACTER OF DISTRIBUTIONS.—Amounts distributed by a charitable remainder annuity trust or by a charitable remainder unitrust shall be considered as having the following characteristics in the hands of a beneficiary to whom is paid the annuity described in subsection (d)(1)(A) or the payment described in subsection (d)(2)(A):

(1) First, as amounts of income (other than gains, and amounts treated as gains, from the sale or other disposition of capital assets) includible in gross income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years;

(2) Second, as a capital gain to the extent of the capital gain of the trust for the year and the undistributed capital gain of the trust for prior years;

(3) Third, as other income to the extent of such income of the trust for the year and such undistributed income of the trust for prior years; and

(4) Fourth, as a distribution of trust corpus.

For purposes of this section, the trust shall determine the amount of its undistributed capital gain on a cumulative net basis.

(c) EXEMPTION FROM INCOME TAXES.—A charitable remainder annuity trust and a charitable remainder unitrust shall, for any taxable year, not be subject to any tax imposed by this subtitle, unless such trust, for such year, has unrelated business taxable income (within the meaning of section 512, determined as if part III of subchapter F applied to such trust).

(d) DEFINITIONS.—

(1) CHARITABLE REMAINDER ANNUITY TRUST.—For purposes of this section, a charitable remainder annuity trust is a trust—

(A) from which a sum certain (which is not less than 5 percent of the initial net fair market value of all property placed in trust) is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) may be paid to or for the use of any person other than an organization described in section 170(c), and

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use.

(2) CHARITABLE REMAINDER UNITRUST.—For purposes of this section, a charitable remainder unitrust is a trust—

(A) from which a fixed percentage (which is not less than 5 percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals,

(B) from which no amount other than the payments described in subparagraph (A) may be paid to or for the use of any person other than an organization described in section 170(c), and

(C) following the termination of the payments described in subparagraph (A), the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use.

(3) EXCEPTION.—Notwithstanding the provisions of paragraphs (2)(A) and (B), the trust instrument may provide that the trustee shall pay the income beneficiary for any year—

(A) the amount of the trust income, if such amount is less than the amount required to be distributed under paragraph (2)(A), and

(B) any amount of the trust income which is in excess of the amount required to be distributed under paragraph (2)(A), to the extent that (by reason of subparagraph (A)) the aggregate of the amounts paid in prior years was less than the aggregate of such required amounts.

(e) VALUATION FOR PURPOSES OF CHARITABLE CONTRIBUTION.—For purposes of determining the amount of any charitable contribution, the remainder interest of a charitable remainder annuity trust or charitable remainder unitrust shall be computed on the basis that an amount equal to 5 percent of the net fair market value of its assets (or a greater amount, if required under the terms of the trust instrument) is to be distributed each year.

(f) CERTAIN CONTINGENCIES PERMITTED.—

(1) GENERAL RULE.—If a trust would, but for a qualified contingency, meet the requirements of paragraph (1)(A) or (2)(A) of subsection (d), such trust shall be treated as meeting such requirements.

(2) VALUE DETERMINED WITHOUT REGARD TO QUALIFIED CONTINGENCY.—For purposes of determining the amount of any charitable contribution (or the actuarial value of any interest), a qualified contingency shall not be taken into account.

(3) QUALIFIED CONTINGENCY.—For purposes of this subsection, the term “qualified contingency” means any provision of a trust which provides that, upon the happening of a contingency, the payments described in paragraph (1)(A) or (2)(A) of subsection (d) (as the case may be) will terminate not later than such payments would otherwise terminate under the trust.

DEFINITIONS APPLICABLE TO SUBPART D

Sec. 665 [1986 Code]. (a) UNDISTRIBUTED NET INCOME.—For purposes of this subpart, the term “undistributed net income” for any taxable year means the amount by which distributable net income of the trust for such taxable year exceeds the sum of—

(1) the amounts for such taxable year specified in paragraphs (1) and (2) of section 661(a); and

(2) the amount of taxes imposed on the trust attributable to such distributable net income.

(b) ACCUMULATION DISTRIBUTION.—For purposes of this subpart, the term “accumulation distribution” means, for any taxable year of the trust, the amount by which—

(1) the amounts specified in paragraph (2) of section 661(a) for such taxable year, exceed

(2) distributable net income for such year reduced (but not below zero) by the amounts specified in paragraph (1) of section 661(a).

For purposes of section 667 (other than subsection (c) thereof, relating to multiple trusts), the amounts specified in paragraph (2) of section 661(a) shall not include amounts properly paid, credited, or required to be distributed to a beneficiary from a trust (other than a foreign trust) as income accumulated before the birth of such beneficiary or before such beneficiary attains the age of 21. If the amounts properly paid, credited, or required to be distributed by the trust for taxable year do not exceed the income of the trust for such year, there shall be no accumulation distribution for such year.

(c) SPECIAL RULE APPLICABLE TO DISTRIBUTIONS BY CERTAIN FOREIGN TRUSTS.—For purposes of this subpart, any amount paid to a United States person which is from a payor who is not a United States person and which is derived directly or indirectly from a foreign trust created by a United States person shall be deemed in the year of payment to have been directly paid by the foreign trust.

(d) TAXES IMPOSED ON THE TRUST.—For purposes of this subpart—

(1) IN GENERAL.—The term "taxes imposed on the trust" means the amount of the taxes which are imposed for any taxable year of the trust under this chapter (without regard to this subpart or part IV of subchapter A) and which, under regulations prescribed by the Secretary, are properly allocable to the undistributed portions of distributable net income and gains in excess of losses from sales or exchanges of capital assets. The amount determined in the preceding sentence shall be reduced by any amount of such taxes deemed distributed under section 666(b) and (c) or 669(d) and (e) to any beneficiary.

(2) FOREIGN TRUSTS.—In the case of any foreign trust, the term "taxes imposed on the trust" includes the amount, reduced as provided in the last sentence of paragraph (1), of any income, war profits, and excess profits taxes imposed by any foreign country or possession of the United States on such foreign trust which, as determined under paragraph (1), are so properly allocable.

(e) PRECEDING TAXABLE YEAR.—For purposes of this subpart—

(1) in the case of a trust (other than a foreign trust created by a United States person), the term "preceding taxable year" does not include any taxable year of the trust—

(A) which precedes by more than 5 years the taxable year of the trust in which an accumulation distribution is made, if it is made in a taxable year beginning before January 1, 1974, or

(B) which begins before January 1, 1969, in the case of an accumulation distribution made during a taxable year beginning after December 31, 1973; and

(2) in the case of a foreign trust created by a United States person, such term does not include any taxable year of the trust to which this part does not apply.

In the case of a preceding taxable year with respect to which a trust qualifies (without regard to this subpart) under the provisions of subpart B, for purposes of the application of this subpart to such trust for such taxable year, such trust shall, in accordance with regulations prescribed by the Secretary, be treated as a trust to which subpart C applies.

ACCUMULATION DISTRIBUTION ALLOCATED TO PRECEDING YEARS

Sec. 666 [1986 Code]. (a) AMOUNT ALLOCATED.—In the case of a trust which is subject to subpart C, the amount of the accumulation distribution of such trust for a taxable year shall be deemed to be an amount within the meaning of paragraph (2) of section 661(a) distributed on the last day of each of the preceding taxable years, commencing with the earliest of such years, to the extent that such amount exceeds the total of any undistributed net income for all earlier preceding taxable years. The amount deemed to be distributed in any such preceding taxable year under the preceding sentence shall not exceed the undistributed net income for such preceding taxable year. For purposes of this subsection, undistributed net income for each of such preceding taxable years shall be computed without regard to such accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

(b) **TOTAL TAXES DEEMED DISTRIBUTED.**—If any portion of an accumulation distribution for any taxable year is deemed under subsection (a) to be an amount within the meaning of paragraph (2) of section 661(a) distributed on the last day of any preceding taxable year, and such portion of such distribution is not less than the undistributed net income for such preceding taxable year, the trust shall be deemed to have distributed on the last day of such preceding taxable year an additional amount within the meaning of paragraph (2) of Section 661(a). Such additional amount shall be equal to the taxes (other than the tax imposed by section 55) imposed on the trust for such preceding taxable year attributable to the undistributed net income. For purposes of this subsection, the undistributed net income and the taxes imposed on the trust for such preceding taxable year attributable to such undistributed net income shall be computed without regard to such accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

(c) **PRO RATA PORTION OF TAXES DEEMED DISTRIBUTED.**—If any portion of an accumulation distribution for any taxable year is deemed under subsection (a) to be an amount within the meaning of paragraph (2) of section 661(a) distributed on the last day of any preceding taxable year and such portion of the accumulation distribution is less than the undistributed net income for such preceding taxable year, the trust shall be deemed to have distributed on the last day of such preceding taxable year an additional amount within the meaning of paragraph (2) of section 661(a). Such additional amount shall be equal to the taxes (other than the tax imposed by section 55) imposed on the trust for such taxable year attributable to the undistributed net income multiplied by the ratio of the portion of the accumulation distribution to the undistributed net income of the trust for such year. For purposes of this subsection, the undistributed net income and the taxes imposed on the trust for such preceding taxable year attributable to such undistributed net income shall be computed without regard to the accumulation distribution and without regard to any accumulation distribution determined for any succeeding taxable year.

(d) **RULE WHEN INFORMATION IS NOT AVAILABLE.**—If adequate records are not available to determine the proper application of this subpart to an amount distributed by a trust, such amount shall be deemed to be an accumulation distribution consisting of undistributed net income earned during the earliest preceding taxable year of the trust in which it can be established that the trust was in existence.

(e) **DENIAL OF REFUND TO TRUSTS AND BENEFICIARIES.**—No refund or credit shall be allowed to a trust or a beneficiary of such trust for any preceding taxable year by reason of a distribution deemed to have been made by such trust in such year under this section.

TREATMENT OF AMOUNTS DEEMED DISTRIBUTED BY TRUST IN PRECEDING YEARS

Sec. 667 [1986 Code]. (a) **GENERAL RULE.**—The total of the amounts which are treated under section 666 as having been distributed by a trust in a preceding taxable year shall be included in the income of a beneficiary of the trust when paid, credited, or required to be distributed to the extent that such total would have been included in the income of such beneficiary under section 662(a) (2) (and, with respect to any tax-exempt interest to which section 103 applies, under section 662(b)) if such total had been paid to such beneficiary on the last day of such preceding taxable year. The tax imposed by this subtitle on a beneficiary for a taxable year in which any such amount is included in his income shall be determined only as provided in this section and shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by an amount equal to the total of such amounts, at the rate and in the manner as if this section had not been enacted,

(2) a partial tax determined as provided in subsection (b) of this section, and

(3) in the case of a foreign trust, the interest charge determined as provided in section 668.

(b) **TAX ON DISTRIBUTION.**—

(1) **IN GENERAL.**—The partial tax imposed by subsection (a) (2) shall be determined—

(A) by determining the number of preceding taxable years of the trust on the last day of which an amount is deemed under section 666(a) to have been distributed,

(B) by taking from the 5 taxable years immediately preceding the year of the accumulation distribution the 1 taxable year for which the beneficiary's taxable income was the highest and the 1 taxable year for which his taxable income was the lowest,

(C) by adding to the beneficiary's taxable income for each of the 3 taxable years remaining after the application of subparagraph (B) an amount determined by dividing the amount deemed distributed under section 666 and required to be included in income under subsection (a) by the number of preceding taxable years determined under subparagraph (A), and

(D) by determining the average increase in tax for the 3 taxable years referred to in subparagraph (C) resulting from the application of such subparagraph.

The partial tax imposed by subsection (a) (2) shall be the excess (if any) of the average increase in tax determined under subparagraph (D), multiplied by the number of preceding taxable years determined under subparagraph (A), over the amount of taxes (other than the amount of taxes described in section 665(d) (2)) deemed distributed to the beneficiary under sections 666(b) and (c).

(2) TREATMENT OF LOSS YEARS.—For purposes of paragraph (1), the taxable income of the beneficiary for any taxable year shall be deemed not to be less than—

(A) in the case of a beneficiary who is an individual, the zero bracket amount for such year, or

(B) in the case of a beneficiary who is a corporation, zero.

(2) TREATMENT OF LOSS YEARS.—For purposes of paragraph (1), the taxable income of the beneficiary for any taxable year shall be deemed to be not less than zero.

(3) CERTAIN PRECEDING TAXABLE YEARS NOT TAKEN INTO ACCOUNT.—For purposes of paragraph (1), if the amount of the undistributed net income deemed distributed in any preceding taxable year of the trust is less than 25 percent of the amount of the accumulation distribution divided by the number of preceding taxable years to which the accumulation distribution is allocated under section 666(a), the number of preceding taxable years of the trust with respect to which an amount is deemed distributed to a beneficiary under section 666(a) shall be determined without regard to such year.

(4) EFFECT OF OTHER ACCUMULATION DISTRIBUTIONS.—In computing the partial tax under paragraph (1) for any beneficiary, the income of such beneficiary for each of his prior taxable years shall include amounts previously deemed distributed to such beneficiary in such year under section 666 as a result of prior accumulation distributions (whether from the same or another trust).

(5) MULTIPLE DISTRIBUTIONS IN THE SAME TAXABLE YEAR.—In the case of accumulation distributions made from more than one trust which are includible in the income of a beneficiary in the same taxable year, the distributions shall be deemed to have been made consecutively in whichever order the beneficiary shall determine.

(6) ADJUSTMENT IN PARTIAL TAX FOR ESTATE AND GENERATION-SKIPPING TRANSFER TAXES ATTRIBUTABLE TO PARTIAL TAX.—

(A) IN GENERAL.—The partial tax shall be reduced by an amount which is equal to the pre-death portion of the partial tax multiplied by a fraction—

(i) the numerator of which is that portion of the tax imposed by chapter 11 or 13, as the case may be, which is attributable (on a proportionate basis) to amounts included in the accumulation distribution, and

(ii) the denominator of which is the amount of the accumulation distribution which is subject to the tax imposed by chapter 11 or 13, as the case may be.

(B) PARTIAL TAX DETERMINED WITHOUT REGARD TO THIS PARAGRAPH.—For purposes of this paragraph, the term "partial tax" means the partial tax imposed by

subsection (a)(2) determined under this subsection without regard to this paragraph.

(C) PRE-DEATH PORTION.—For purposes of this paragraph, the pre-death portion of the partial tax shall be an amount which bears the same ratio to the partial tax as the portion of the accumulation distribution which is attributable to the period before the date of the death of the decedent or the date of the generation-skipping transfer bears to the total accumulation distribution.

(c) SPECIAL RULE FOR MULTIPLE TRUSTS.—

(1) IN GENERAL.—If, in the same prior taxable year of the beneficiary in which any part of the accumulation distribution from a trust (hereinafter in this paragraph referred to as "third trust") is deemed under section 666(a) to have been distributed to such beneficiary, some part of prior distributions by each of 2 or more other trusts is deemed under section 666(a) to have been distributed to such beneficiary, then subsections (b) and (c) of section 666 shall not apply with respect to such part of the accumulation distribution from such third trust.

(2) ACCUMULATION DISTRIBUTIONS FROM TRUST NOT TAKEN INTO ACCOUNT UNLESS THEY EQUAL OR EXCEED \$1,000.—For purposes of paragraph (1), an accumulation distribution from a trust to a beneficiary shall be taken into account only if such distribution, when added to any prior accumulation distributions from such trust which are deemed under section 666(a) to have been distributed to such beneficiary for the same prior taxable year of the beneficiary, equals or exceeds \$1,000.

(d) SPECIAL RULES FOR FOREIGN TRUST.—

(1) FOREIGN TAX DEEMED PAID BY BENEFICIARY.—

(A) IN GENERAL.—In determining the increase in tax under subsection (b)(1)(D) for any computation year, the taxes described in section 665(d)(2) which are deemed distributed under section 666(b) or (c) and added under subsection (b)(1)(C) to the taxable income of the beneficiary for any computation year shall, except as provided in subparagraphs (B) and (C), be treated as a credit against the increase in tax for such computation year under subsection (b)(1)(D).

(B) DEDUCTION IN LIEU OF CREDIT.—If the beneficiary did not choose the benefits of subpart A of part III of subchapter N with respect to the computation year, the beneficiary may in lieu of treating the amounts described in subparagraph (A) (without regard to subparagraph (C)) as a credit may treat such amounts as a deduction in computing the beneficiary's taxable income under subsection (b)(1)(C) for the computation year.

(C) LIMITATION ON CREDIT; RETENTION OF CHARACTER.—

(i) LIMITATION ON CREDIT.—For purposes of determining under subparagraph (A) the amount treated as a credit for any computation year, the limitations under subpart A of part III of subchapter N shall be applied separately with respect to amounts added under subsection (b)(1)(C) to the taxable income of the beneficiary for such computation year. For purposes of computing the increase in tax under subsection (b)(1)(D) for any computation year for which the beneficiary did not choose the benefits of subpart A of part III of subchapter N, the beneficiary shall be treated as having chosen such benefits for such computation year.

(ii) RETENTION OF CHARACTER.—The items of income, deduction, and credit of the Trust shall retain their character (subject to the application of section 904(f)(5)) to the extent necessary to apply this paragraph.

(D) COMPUTATION YEAR.—For purposes of this paragraph, the term "computation year" means any of the three taxable years remaining after application of subsection (b)(1)(B).

(e) RETENTION OF CHARACTER OF AMOUNTS DISTRIBUTED FROM ACCUMULATION TRUST TO NONRESIDENT ALIENS AND FOREIGN CORPORATIONS.—In the case of a distribution from a trust to a nonresident alien individual or to a foreign corporation, the first sentence of subsection (a) shall be applied as if the reference to the determination of character under section 662(b) applied to all amounts instead of just to tax-exempt interest.

INTEREST CHARGE ON ACCUMULATION DISTRIBUTIONS FROM FOREIGN TRUSTS

Sec. 668 [1986 Code]. (a) GENERAL RULE.—For purposes of the tax determined under section 667(a), the interest charge is an amount equal to 6 percent of the partial tax computed under section 667(b) multiplied by a fraction—

(1) the numerator of which is the sum of the number of taxable years between each taxable year to which the distribution is allocated under section 666(a) and the taxable year of the distribution (counting in each case the taxable year to which the distribution is allocated but not counting the taxable year of the distribution), and

(2) the denominator of which is the number of taxable years to which the distribution is allocated under section 666(a).

(b) LIMITATION.—The total amount of the interest charge shall not, when added to the total partial tax computed under section 667(b), exceed the amount of the accumulation distribution (other than the amount of tax deemed distributed by section 666(b) or (c)) in respect of which such partial tax was determined.

(c) SPECIAL RULES.—

(1) INTEREST CHARGE NOT DEDUCTIBLE.—The interest charge determined under this section shall not be allowed as a deduction for purposes of any tax imposed by this title.

(2) TRANSITIONAL RULE.—For purposes of this section, undistributed net income existing in a trust as of January 1, 1977, shall be treated as allocated under section 666(a) to the first taxable year beginning after December 31, 1976.

GRANTOR TRUSTS • DECEDENTS

TRUST INCOME, DEDUCTIONS, AND CREDITS ATTRIBUTABLE TO GRANTORS AND OTHERS AS SUBSTANTIAL OWNERS

Sec. 671 [1986 Code]. Where it is specified in this subpart that the grantor or another person shall be treated as the owner of any portion of a trust, there shall then be included in computing the taxable income and credits of the grantor or the other person those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under this chapter in computing taxable income or credits against the tax of an individual. Any remaining portion of the trust shall be subject to subparts A through D. No items of a trust shall be included in computing the taxable income and credits of the grantor or of any other person solely on the grounds of his dominion and control over the trust under section 61 (relating to definition of gross income) or any other provision of this title, except as specified in this subpart.

DEFINITIONS AND RULES

Sec. 672 [1986 Code]. (a) ADVERSE PARTY.—For purposes of this subpart, the term "adverse party" means any person having a substantial beneficial interest in the trust which would be adversely affected by the exercise or nonexercise of the power which he possesses respecting the trust. A person having a general power of appointment over the trust property shall be deemed to have a beneficial interest in the trust.

(b) NONADVERSE PARTY.—For purposes of this subpart, the term "nonadverse party" means any person who is not an adverse party.

(c) RELATED OR SUBORDINATE PARTY.—For purposes of this subpart, the term "related or subordinate party" means any nonadverse party who is—

(1) the grantor's spouse if living with the grantor;

(2) any one of the following: The grantor's father, mother, issue, brother or sister, an employee of the grantor; a corporation or any employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; a subordinate employee of a corporation in which the grantor is an executive.

For purposes of sections 674 and 675, a related or subordinate party shall be presumed to be subservient to the grantor in respect of the exercise or nonexercise of the powers conferred on him unless such party is shown not to be subservient by a preponderance of the evidence.

(d) RULE WHERE POWER IS SUBJECT TO CONDITION PRECEDENT.—A person shall be considered to have a power described in this subpart even though the exercise of the power is subject to a precedent giving of notice or takes effect only on the expiration of a certain period after the exercise of the power.

(e) GRANTOR TREATED AS HOLDING ANY POWER OR INTEREST OF GRANTOR'S SPOUSE.—For purposes of this subpart, if a grantor's spouse is living with the grantor at the time of the creation of any power or interest held by such spouse, the grantor shall be treated as holding such power or interest.

REVERSIONARY INTERESTS

Sec. 673 [1986 Code]. (a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom if, as of the inception of that portion of the trust, the interest will or may reasonably be expected to take effect in possession or enjoyment within 10 years commencing with the date of the transfer of that portion of the trust.

[(b)—repealed]

(c) REVERSIONARY INTEREST TAKING EFFECT AT DEATH OF INCOME BENEFICIARY.—The grantor shall not be treated under subsection (a) as the owner of any portion of a trust where his reversionary interest in such portion is not to take effect in possession or enjoyment until the death of the person or persons to whom the income therefrom is payable.

(d) POSTPONEMENT OF DATE SPECIFIED FOR REACQUISITION.—Any postponement of the date specified for the reacquisition of possession or enjoyment of the reversionary interest shall be treated as a new transfer in trust commencing with the date on which the postponement is effected and terminating with the date prescribed by the postponement. However, income for any period shall not be included in the income of the grantor by reason of the preceding sentence if such income would not be so includible in the absence of such postponement.

(a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

(b) REVERSIONARY INTEREST TAKING EFFECT AT DEATH OF MINOR LINEAL DESCENDANT BENEFICIARY.—In the case of any beneficiary who—

(1) is a lineal descendant of the grantor, and

(2) holds all of the present interests in any portion of a trust, the grantor shall not be treated under subsection (a) as the owner of such portion solely by reason of a reversionary interest in such portion which takes effect upon the death of such beneficiary before such beneficiary attains age 21.

POWER TO CONTROL BENEFICIAL ENJOYMENT

Sec. 674 [1986 Code]. (a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(b) EXCEPTIONS FOR CERTAIN POWERS.—Subsection (a) shall not apply to the following powers regardless of by whom held:

(1) POWER TO APPLY INCOME TO SUPPORT OF A DEPENDENT.—A power described in section 677(b) to the extent that the grantor would not be subject to tax under that section.

(2) **POWER AFFECTING BENEFICIAL ENJOYMENT ONLY AFTER EXPIRATION OF 10-YEAR PERIOD.**—A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

(2) **POWER AFFECTING BENEFICIAL ENJOYMENT ONLY AFTER OCCURRENCE OF EVENT.**—A power, the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the occurrence of the event unless the power is relinquished.

(3) **POWER EXERCISABLE ONLY BY WILL.**—A power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

(4) **POWER TO ALLOCATE AMONG CHARITABLE BENEFICIARIES.**—A power to determine the beneficial enjoyment of the corpus or the income therefrom if the corpus or income is irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions).

(5) **POWER TO DISTRIBUTE CORPUS.**—A power to distribute corpus either—

(A) to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries) provided that the power is limited by a reasonably definite standard which is set forth in the trust instrument; or

(B) to or for any current income beneficiary, provided that the distribution of corpus must be chargeable against the proportionate share of corpus held in trust for the payment of income to the beneficiary as if the corpus constituted a separate trust.

A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(6) **POWER TO WITHHOLD INCOME TEMPORARILY.**—A power to distribute or apply income to or for any current income beneficiary or to accumulate the income for him, provided that any accumulated income must ultimately be payable—

(A) to the beneficiary from whom distribution or application is withheld, to his estate, or to his appointees (or persons named as alternate takers in default of appointment) provided that such beneficiary possesses a power of appointment which does not exclude from the class of possible appointees any person other than the beneficiary, his estate, his creditors, or the creditors of his estate, or

(B) on termination of the trust, or in conjunction with a distribution of corpus which is augmented by such accumulated income, to the current income beneficiaries in shares which have been irrevocably specified in the trust instrument.

Accumulated income shall be considered so payable although it is provided that if any beneficiary does not survive a date of distribution which could reasonably have been expected to occur within the beneficiary's lifetime, the share of the deceased beneficiary is to be paid to his appointees or to one or more designated alternate takers (other than the grantor or the grantor's estate) whose shares have been irrevocably specified. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children.

(7) **POWER TO WITHHOLD INCOME DURING DISABILITY OF A BENEFICIARY.**—A power exercisable only during—

(A) the existence of a legal disability of any current income beneficiary, or

(B) the period during which any income beneficiary shall be under the age of 21 years,

to distribute or apply income to or for such beneficiary or to accumulate and add the income to corpus. A power does not fall within the powers described in this paragraph if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(8) POWER TO ALLOCATE BETWEEN CORPUS AND INCOME.—A power to allocate receipts and disbursements as between corpus and income, even though expressed in broad language.

(c) EXCEPTION FOR CERTAIN POWERS OF INDEPENDENT TRUSTEES.—Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor, and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor—

(1) to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries; or

(2) to pay out corpus to or for a beneficiary or beneficiaries or to or for a class of beneficiaries (whether or not income beneficiaries).

A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus, except where such action is to provide for after-born or after-adopted children.

(d) POWER TO ALLOCATE INCOME IF LIMITED BY A STANDARD.—Subsection (a) shall not apply to a power solely exercisable (without the approval or consent of any other person) by a trustee or trustees, none of whom is the grantor or spouse living with the grantor, to distribute, apportion, or accumulate income to or for a beneficiary or beneficiaries, or to, for, or within a class of beneficiaries, whether or not the conditions of paragraph (6) or (7) of subsection (b) are satisfied, if such power is limited by a reasonably definite external standard which is set forth in the trust instrument. A power does not fall within the powers described in this subsection if any person has a power to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus except where such action is to provide for after-born or after-adopted children.

ADMINISTRATIVE POWERS

Sec. 675 [1986 Code]. The grantor shall be treated as the owner of any portion of a trust in respect of which—

(1) POWER TO DEAL FOR LESS THAN ADEQUATE AND FULL CONSIDERATION.—A power exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party enables the grantor or any person to purchase, exchange, or otherwise deal with or dispose of the corpus or the income therefrom for less than an adequate consideration in money or money's worth.

(2) POWER TO BORROW WITHOUT ADEQUATE INTEREST OR SECURITY.—A power exercisable by the grantor or a nonadverse party, or both, enables the grantor to borrow the corpus or income, directly or indirectly, without adequate interest or without adequate security except where a trustee (other than the grantor) is authorized under a general lending power to make loans to any person without regard to interest or security.

(3) BORROWING OF THE TRUST FUNDS.—The grantor has directly or indirectly borrowed the corpus or income and has not completely repaid the loan, including any interest, before the beginning of the taxable year. The preceding sentence shall not apply to a loan which provides for adequate interest and adequate security, if such loan is made by a trustee other than the grantor and other than a related or subordinate trustee subservient to the grantor.

(4) GENERAL POWERS OF ADMINISTRATION.—A power of administration is exercisable in a nonfiduciary capacity by any person without the approval or consent of any person in a fiduciary capacity. For purposes of this paragraph, the term "power of administration" means any one or more of the following powers: (A) a power to vote or direct the voting of stock or other securities of a corporation in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; (B) a power to control the investment of the trust funds either by directing investments or reinvestments, or by vetoing proposed investments or reinvestments, to the extent that the trust funds consist of stocks or securities of corporations in which the holdings of the grantor and the trust are significant from the viewpoint of voting control; or (C) a power to reacquire the trust corpus by substituting other property of an equivalent value.

POWER TO REVOKE

Sec. 676 [1986 Code]. (a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under any other provision of this part, where at any time the power to revest in the grantor title to such portion is exercisable by the grantor or a non-adverse party, or both.

(b) POWER AFFECTING BENEFICIAL ENJOYMENT ONLY AFTER EXPIRATION OF 10-YEAR PERIOD.—Subsection (a) shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest. But the grantor may be treated as the owner after the expiration of such period unless the power is relinquished.

(b) POWER AFFECTING BENEFICIAL ENJOYMENT ONLY AFTER OCCURRENCE OF EVENT.—Subsection (a) shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the occurrence of an event such that a grantor would not be treated as the owner under section 673 if the power were a reversionary interest. But the grantor may be treated as the owner after the occurrence of such event unless the power is relinquished.

INCOME FOR BENEFIT OF GRANTOR

Sec. 677 [1986 Code]: (a) GENERAL RULE.—The grantor shall be treated as the owner of any portion of a trust, whether or not he is treated as such owner under section 674, whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be—

- (1) distributed to the grantor or the grantor's spouse;
- (2) held or accumulated for future distribution to the grantor or the grantor's spouse; or
- (3) applied to the payment of premiums on policies of insurance on the life of the grantor or the grantor's spouse (except policies of insurance irrevocably payable for a purpose specified in section 170(c) (relating to definition of charitable contributions)).

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after *the occurrence of an event* such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after *the occurrence of the event* unless the power is relinquished.

(b) OBLIGATIONS OF SUPPORT.—Income of a trust shall not be considered taxable to the grantor under subsection (a) or any other provision of this chapter merely because such income in the discretion of another person, the trustee, or the grantor acting as trustee or co-trustee, may be applied or distributed for the support or maintenance of a beneficiary (other than the grantor's spouse) whom the grantor is legally obligated to support or maintain, except to the extent that such income is so applied or distributed. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income for the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661(a) and shall be taxed to the grantor under section 662.

PERSON OTHER THAN GRANTOR TREATED AS SUBSTANTIAL OWNER

Sec. 678 [1986 Code]. (a) GENERAL RULE.—A person other than the grantor shall be treated as the owner of any portion of a trust with respect to which:

(1) such person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself, or

(2) such person has previously partially released or otherwise modified such a power and after the release or modification retains such control as would, within the principles of sections 671 to 677, inclusive, subject a grantor of a trust to treatment as the owner thereof.

(b) EXCEPTION WHERE GRANTOR IS TAXABLE.—Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section.

(c) OBLIGATIONS OF SUPPORT.—Subsection (a) shall not apply to a power which enables such person, in the capacity of trustee or co-trustee, merely to apply the income of the trust to the support or maintenance of a person whom the holder of the power is obligated to support or maintain except to the extent that such income is so applied. In cases where the amounts so applied or distributed are paid out of corpus or out of other than income of the taxable year, such amounts shall be considered to be an amount paid or credited within the meaning of paragraph (2) of section 661(a) and shall be taxed to the holder of the power under section 662.

(d) EFFECT OF RENUNCIATION OR DISCLAIMER.—Subsection (a) shall not apply with respect to a power which has been renounced or disclaimed within a reasonable time after the holder of the power first became aware of its existence.

(e) CROSS REFERENCE.—

For provision under which beneficiary of trust is treated as owner of the portion of the trust which consists of stock in an electing small business corporation, see section 1361(d).

FOREIGN TRUSTS HAVING ONE OR MORE UNITED STATES BENEFICIARIES

Sec. 679 [1986 Code]. (a) TRANSFEROR TREATED AS OWNER.—

(1) IN GENERAL.—A United States person who directly or indirectly transfers property to a foreign trust (other than a trust described in section 404(a)(4) or section 404A) shall be treated as the owner for his taxable year of the portion of such trust attributable to such property if for such year there is a United States beneficiary of any portion of such trust.

(2) EXCEPTIONS.—Paragraph (1) shall not apply—

(A) TRANSFERS BY REASON OF DEATH.—To any transfer by reason of death of the transferor.

(B) TRANSFERS WHERE GAIN IS RECOGNIZED TO TRANSFEROR.—To any sale or exchange of the property at its fair market value in a transaction in which all of the

gain to the transferor is realized at the time of the transfer and is recognized either at such time or is returned as provided in section 453.

(b) TRUSTS ACQUIRING UNITED STATES BENEFICIARIES.—If—

(1) subsection (a) applies to a trust for the transferor's taxable year, and

(2) subsection (a) would have applied to the trust for his immediately preceding taxable year but for the fact that for such preceding taxable year there was no United States beneficiary for any portion of the trust,

then, for purposes of this subtitle, the transferor shall be treated as having income for the taxable year (in addition to his other income for such year) equal to the undistributed net income (at the close of such immediately preceding taxable year) attributable to the portion of the trust referred to in subsection (a).

(c) TRUSTS TREATED AS HAVING A UNITED STATES BENEFICIARY.—

(1) **IN GENERAL.**—For purposes of this section, a trust shall be treated as having a United States beneficiary for the taxable year unless—

(A) under the terms of the trust, no part of the income or corpus of the trust may be paid or accumulated during the taxable year to or for the benefit of a United States person, and

(B) if the trust were terminated at any time during the taxable year, no part of the income or corpus of such trust could be paid to or for the benefit of a United States person.

(2) **ATTRIBUTION OF OWNERSHIP.**—For purposes of paragraph (1), an amount shall be treated as paid or accumulated to or for the benefit of a United States person if such amount is paid to or accumulated for a foreign corporation, foreign partnership, or foreign trust or estate, and—

(A) in the case of a foreign corporation, more than 50 percent of the total combined voting power of all classes of stock entitled to vote of such corporation is owned (within the meaning of section 958(a)) or is considered to be owned (within the meaning of section 958(b)) by United States shareholders (as defined in section 951(b)),

(B) in the case of a foreign partnership, a United States person is a partner of such partnership, or

(C) in the case of a foreign trust or estate, such trust or estate has a United States beneficiary (within the meaning of paragraph (1)).

LIMITATION ON CHARITABLE DEDUCTION

Sec. 681 [1986 Code]. (a) **TRADE OR BUSINESS INCOME.**—In computing the deduction allowable under section 642(c) to a trust, no amount otherwise allowable under section 642(c) as a deduction shall be allowed as a deduction with respect to income of the taxable year which is allocable to its unrelated business income for such year. For purposes of the preceding sentence, the term "unrelated business income" means an amount equal to the amount which, if such trust were exempt from tax under section 501(a) by reason of section 501(c)(3), would be computed as its unrelated business taxable income under section 512 (relating to income derived from certain business activities and from certain property acquired with borrowed funds).

(b) **CROSS REFERENCE.**—

For disallowance of certain charitable, etc., deductions otherwise allowable under section 642(c), see sections 508(d) and 4948(c)(4).

INCOME OF AN ESTATE OR TRUST IN CASE OF DIVORCE, ETC.

Sec. 682 [1986 Code]. (a) **INCLUSION IN GROSS INCOME OF WIFE.**—There shall be included in the gross income of a wife who is divorced or legally separated under a decree of divorce or of separate maintenance (or who is separated from her husband under a written separation agreement) the amount of the income of any trust which such wife is entitled to receive and which, except for this section, would be includible in the gross income of her husband, and such amount shall not, despite any other provision of this subtitle, be includible in the gross income of such husband. This subsection shall not apply to that part of any such income of the trust which the terms of the decree, written separation agreement, or trust instrument fix, in terms of an amount of money or a portion of such income, as a sum which is payable for the support of minor children of such husband. In case such income is less than the amount specified in the decree, agreement, or instrument, for the purpose of applying the preceding sentence, such income, to the extent of such sum payable for such support, shall be considered a payment for such support.

(b) **WIFE CONSIDERED A BENEFICIARY.**—For purposes of computing the taxable income of the estate or trust and the taxable income of a wife to whom subsection (a) or section 71 applies, such wife shall be considered as the beneficiary specified in this part. A periodic payment under section 71 to any portion of which this part applies shall be included in the gross income of the beneficiary in the taxable year in which under this part such portion is required to be included.

(b) **WIFE CONSIDERED A BENEFICIARY.**—For purposes of computing the taxable income of the estate or trust and the taxable income of a wife to whom subsection (a) applies, such wife shall be considered as the beneficiary specified in this part.

(c) **CROSS REFERENCE.**—

For definitions of "husband" and "wife", as used in this section, see section 7701(a)(17).

USE OF TRUST AS AN EXCHANGE FUND

Sec. 683 [1986 Code]. (a) GENERAL RULE.—Except as provided in subsection (b), if property is transferred to a trust in exchange for an interest in other trust property and if the trust would be an investment company (within the meaning of section 351) if it were a corporation, then gain shall be recognized to the transferor.

(b) EXCEPTION FOR POOLED INCOME FUNDS.—Subsection (a) shall not apply to any transfer to a pooled income fund (within the meaning of section 642(c)(5)).

DECEDENTS

RECIPIENTS OF INCOME IN RESPECT OF DECEDENTS

Sec. 691 [1986 Code]. (a) INCLUSION IN GROSS INCOME.—

(1) GENERAL RULE.—The amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period (including the amount of all items of gross income in respect of a prior decedent, if the right to receive such amount was acquired by reason of the death of the prior decedent or by bequest, devise, or inheritance from the prior decedent) shall be included in the gross income, for the taxable year when received, of:

(A) the estate of the decedent, if the right to receive the amount is acquired by the decedent's estate from the decedent;

(B) the person who, by reason of the death of the decedent, acquires the right to receive the amount, if the right to receive the amount is not acquired by the decedent's estate from the decedent; or

(C) the person who acquires from the decedent the right to receive the amount by bequest, devise, or inheritance, if the amount is received after a distribution by the decedent's estate of such right.

(2) INCOME IN CASE OF SALE, ETC.—If a right, described in paragraph (1), to receive an amount is transferred by the estate of the decedent or a person who received such right by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent, there shall be included in the gross income of the estate or such person, as the case may be, for the taxable period in which the transfer occurs, the fair market value of such right at the time of such transfer plus the amount by which any consideration for the transfer exceeds such fair market value. For purposes of this paragraph, the term "transfer" includes sale, exchange, or other disposition, or the satisfaction of an installment obligation at other than face value, but does not include transmission at death to the estate of the decedent or a transfer to a person pursuant to the right of such person to receive such amount by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent.

(3) CHARACTER OF INCOME DETERMINED BY REFERENCE TO DECEDENT.—The right, described in paragraph (1), to receive an amount shall be treated, in the hands of the estate of the decedent or any person who acquired such right by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to have the character which it would have had in the hands of the decedent if the decedent had lived and received such amount.

(4) INSTALLMENT OBLIGATIONS ACQUIRED FROM DECEDENT.—In the case of an installment obligation reportable by the decedent on the installment method under section 453 or 453A, if such obligation is acquired by the decedent's estate from the decedent or by any person by reason of the death of the decedent or by bequest, devise, or inheritance from the decedent—

(A) an amount equal to the excess of the face amount of such obligation over the basis of the obligation in the hands of the decedent (determined under section 453B) shall, for the purpose of paragraph (1), be considered as an item of gross income in respect of the decedent; and

(B) such obligation shall, for purposes of paragraphs (2) and (3), be considered a right to receive an item of gross income in respect of the decedent, but the amount includible in gross income under paragraph (2) shall be reduced by an amount equal to the basis of the obligation in the hands of the decedent (determined under section 453B).

(5) OTHER RULES RELATING TO INSTALLMENT OBLIGATIONS.—

(A) IN GENERAL.—In the case of an installment obligation reportable by the decedent on the installment method under section 453 or 453A, for purposes of paragraph (2)—

(i) the second sentence of paragraph (2) shall be applied by inserting “(other than the obligor)” after “or a transfer to a person”,

(ii) any cancellation of such an obligation shall be treated as a transfer, and

(iii) any cancellation of such an obligation occurring at the death of the decedent shall be treated as a transfer by the estate of the decedent (or, if held by a person other than the decedent before the death of the decedent, by such person).

(B) FACE AMOUNT TREATED AS FAIR MARKET VALUE IN CERTAIN CASES.—In any case to which the first sentence of paragraph (2) applies by reason of subparagraph (A), if the decedent and the obligor were related persons (within the meaning of section 453(f)(1)), the fair market value of the installment obligation shall be treated as not less than its face amount.

(C) CANCELLATION INCLUDES BECOMING UNENFORCEABLE.—For purposes of subparagraph (A), an installment obligation which becomes unenforceable shall be treated as if it were canceled.

(b) ALLOWANCE OF DEDUCTIONS AND CREDIT.—The amount of any deduction specified in section 162, 163, 164, 212, or 611 (relating to deductions for expenses, interest, taxes, and depletion) or credit specified in section 27 (relating to foreign tax credit), in respect of a decedent which is not properly allowable to the decedent in respect of the taxable period in which falls the date of his death, or a prior period, shall be allowed:

(1) EXPENSES, INTEREST, AND TAXES.—In the case of a deduction specified in section 162, 163, 164, or 212 and a credit specified in section 27, in the taxable year when paid—

(A) to the estate of the decedent; except that

(B) if the estate of the decedent is not liable to discharge the obligation to which the deduction or credit relates, to the person who, by reason of the death of the decedent or by bequest, devise, or inheritance acquires, subject to such obligation, from the decedent an interest in property of the decedent.

(2) DEPLETION.—In the case of the deduction specified in section 611, to the person described in subsection (a)(1)(A), (B), or (C) who, in the manner described therein, receives the income to which the deduction relates, in the taxable year when such income is received.

(c) DEDUCTION FOR ESTATE TAX.—

(1) ALLOWANCE OF DEDUCTION.—

(A) GENERAL RULE.—A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a)(1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a)(1).

(B) ESTATES AND TRUSTS.—In the case of an estate or trust, the amount allowed as a deduction under subparagraph (A) shall be computed by excluding from the gross income of the estate or trust the portion (if any) of the items described in subsection (a)(1) which is properly paid, credited, or to be distributed to the beneficiaries during the taxable year.

(2) METHOD OF COMPUTING DEDUCTION.—For purposes of paragraph (1)—

(A) The term “estate tax” means the tax imposed on the estate of the decedent or any prior decedent under section 2001 or 2101, reduced by the credits against such tax.

(B) The net value for estate tax purposes of all the items described in subsection (a)(1) shall be the excess of the value for estate tax purposes of all the items described in subsection (a)(1) over the deductions from the gross estate in respect of claims which represent the deductions and credit described in subsection (b). Such net value shall be determined with respect to the provisions of section 421(c)(2), relating to the deduction for estate tax with respect to stock options to which part II of subchapter D applies.

(C) The estate tax attributable to such net value shall be an amount equal to the excess of the estate tax over the estate tax computed without including in the gross estate such net value.

(3) SPECIAL RULE FOR GENERATION-SKIPPING TRANSFERS.—For purposes of this section—

(A) the tax imposed by section 2601 or any State inheritance tax described in section 2602(c)(5)(B) on any generation-skipping transfer shall be treated as a tax imposed by section 2001 on the estate of the deemed transferor (as defined in section 2612(a));

(B) any property transferred in such a transfer shall be treated as if it were included in the gross estate of the deemed transferor at the value of such property taken into account for purposes of the tax imposed by section 2601; and

(C) under regulations prescribed by the secretary, any item of gross income subject to the tax imposed under section 2601 shall be treated as income described in subsection (a) if such item is not properly includible in the gross income of the trust on or before the date of the generation-skipping transfer (within the meaning of section 2611(a)) and if such transfer occurs at or after the death of the deemed transferor (as so defined).

(3) SPECIAL RULE FOR GENERATION-SKIPPING TRANSFERS.—In the case of any tax imposed by chapter 13 on a taxable termination or a direct skip occurring as a result of the death of the transferor, there shall be allowed a deduction (under principles similar to the principles of this subsection) for the portion of such tax attributable to items of gross income of the trust which were not properly includible in the gross income of the trust for periods before the date of such termination.

(4) COORDINATION WITH CAPITAL GAIN DEDUCTION, ETC.—For purposes of sections 1201, 1202, and 1211, and for purposes of section 57(a)(9), the amount of any gain taken into account with respect to any item described in subsection (a)(1) shall be reduced (but not below zero) by the amount of the deduction allowable under paragraph (1) of this subsection with respect to such item.

(4) COORDINATION WITH CAPITAL GAIN PROVISIONS.—For purposes of sections 1(j), 1201, and 1211, the amount of any gain taken into account with respect to any item described in subsection (a)(1) shall be reduced (but not below zero) by the amount of the deduction allowable under paragraph (1) of this subsection with respect to such item.

(5) COORDINATION WITH SECTION 402(e).—For purposes of section 402(e) (other than paragraph (1)(D) thereof), the total taxable amount of any lump sum distribution shall be reduced by the amount of the deduction allowable under paragraph (1) of this subsection which is attributable to the total taxable amount (determined without regard to this paragraph).

(d) AMOUNTS RECEIVED BY SURVIVING ANNUITANT UNDER JOINT AND SURVIVOR ANNUITY CONTRACT.—

(1) DEDUCTION FOR ESTATE TAX.—For purposes of computing the deduction under subsection (c)(1)(A), amounts received by a surviving annuitant—

(A) as an annuity under a joint and survivor annuity contract where the decedent annuitant died after December 31, 1953, and after the annuity starting date (as defined in section 72(c)(4)), and

(B) during the surviving annuitant's life expectancy period, shall, to the extent included in gross income under section 72, be considered as amounts included in gross income under subsection (a).

(2) NET VALUE FOR ESTATE TAX PURPOSES.—In determining the net value for estate tax purposes under subsection (c)(2)(B) for purposes of this subsection, the value for estate tax purposes of the items described in paragraph (1) of this subsection shall be computed—

(A) by determining the excess of the value of the annuity at the date of the death of the deceased annuitant over the total amount excludable from the gross income of the surviving annuitant under section 72 during the surviving annuitant's life expectancy period, and

(B) by multiplying the figure so obtained by the ratio which the value of the annuity for estate tax purposes bears to the value of the annuity at the date of the death of the deceased.

(3) DEFINITIONS.—For purposes of this subsection—

(A) The term "life expectancy period" means the period beginning with the first day of the first period for which an amount is received by the surviving annuitant under the contract and ending with the close of the taxable year with or in which falls the termination of the life expectancy of the surviving annuitant. For purposes of this subparagraph, the life expectancy of the surviving annuitant shall

be determined, as of the date of the death of the deceased annuitant, with reference to actuarial tables prescribed by the Secretary.

(B) The surviving annuitant's expected return under the contract shall be computed, as of the death of the deceased annuitant, with reference to actuarial tables prescribed by the Secretary.

(e) CROSS REFERENCE.—

For application of this section to income in respect of a deceased partner, see section 753.

INCOME TAXES OF MEMBERS OF ARMED FORCES ON DEATH

Sec. 692 [1986 Code]. (a) GENERAL RULE.—In the case of any individual who dies while in active service as a member of the Armed Forces of the United States, if such death occurred while serving in a combat zone (as determined under section 112) or as a result of wounds, disease, or injury incurred while so serving—

(1) any tax imposed by this subtitle shall not apply with respect to the taxable year in which falls the date of his death, or with respect to any prior taxable year ending on or after the first day he so served in a combat zone after June 24, 1950; and

(2) any tax under this subtitle and under the corresponding provisions of prior revenue laws for taxable years preceding those specified in paragraph (1) which is unpaid at the date of his death (including interest, additions to the tax, and additional amounts) shall not be assessed, and if assessed the assessment shall be abated, and if collected shall be credited or refunded as an overpayment.

(b) INDIVIDUALS IN MISSING STATUS.—For purposes of this section, in the case of an individual who was in a missing status within the meaning of section 6013(f)(3)(A), the date of his death shall be treated as being not earlier than the date on which a determination of his death is made under section 556 of title 37 of the United States Code. Except in the case of

the combat zone designated for purposes of the Vietnam conflict, the preceding sentence shall not cause subsection (a)(1) to apply for any taxable year beginning more than 2 years after the date designated under section 112 as the date of termination of combatant activities in a combat zone.

(c) CERTAIN MILITARY OR CIVILIAN EMPLOYEES OF THE UNITED STATES DYING AS A RESULT OF INJURIES SUSTAINED OVERSEAS.—

(1) IN GENERAL.—In the case of any individual who dies while a military or civilian employee of the United States, if such death occurs as a result of wounds or injury which was incurred while the individual was a military or civilian employee of the United States and which was incurred outside the United States in a terroristic or military action, any tax imposed by this subtitle shall not apply—

(A) with respect to the taxable year in which falls the date of his death, and

(B) with respect to any prior taxable year in the period beginning with the last taxable year ending before the taxable year in which the wounds or injury were incurred.

(2) TERRORISTIC OR MILITARY ACTION.—For purposes of paragraph (1), the term "terroristic or military action" means—

(A) any terroristic activity which a preponderance of the evidence indicates was directed against the United States or any of its allies, and

(B) any military action involving the Armed Forces of the United States and resulting from violence or aggression against the United States or any of its allies (or threat thereof).

For purposes of the preceding sentence, the term "military action" does not include training exercises.

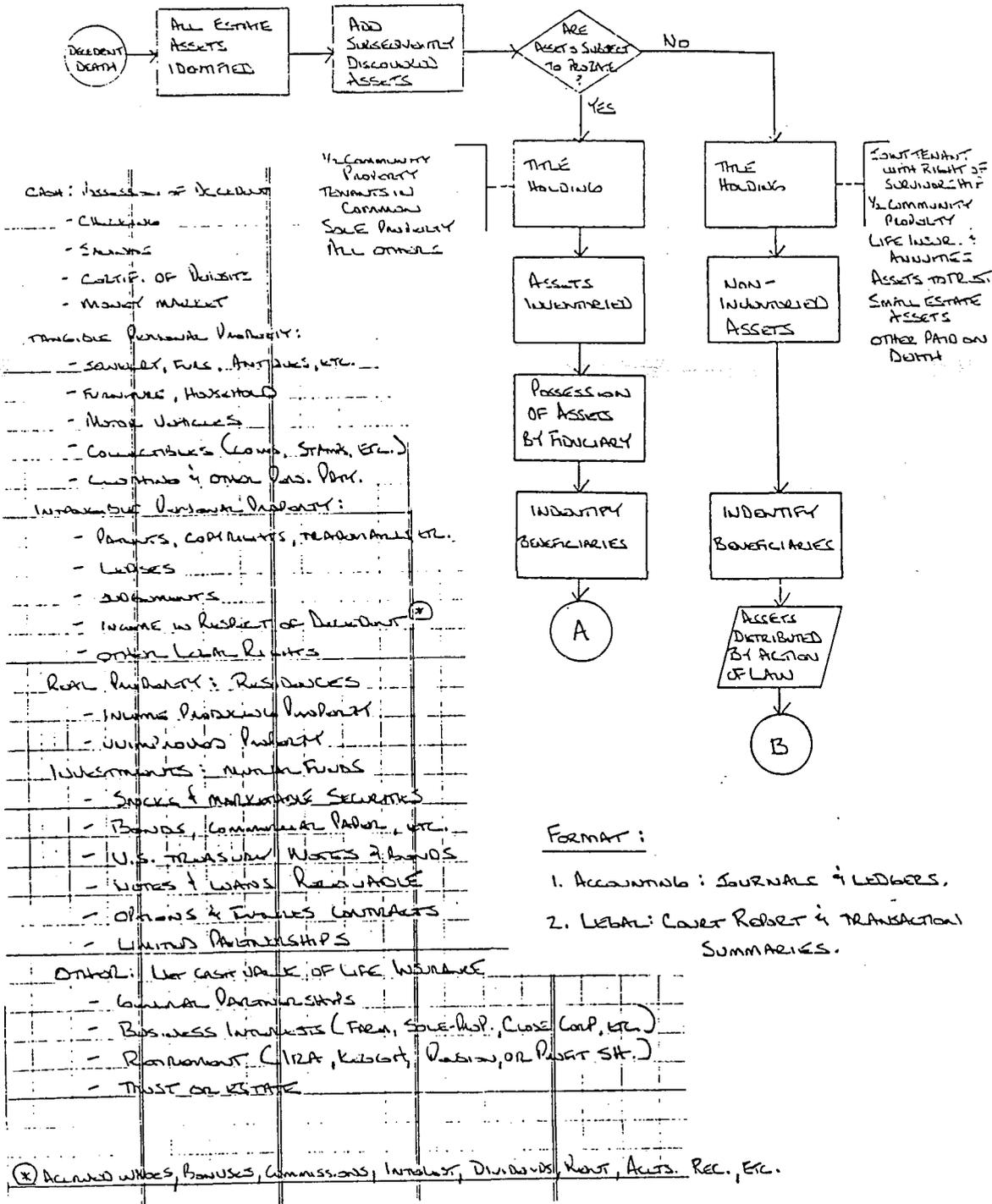
(3) TREATMENT OF MULTINATIONAL FORCES.—For purposes of paragraph (2), any multinational force in which the United States is participating shall be treated as an ally of the United States.

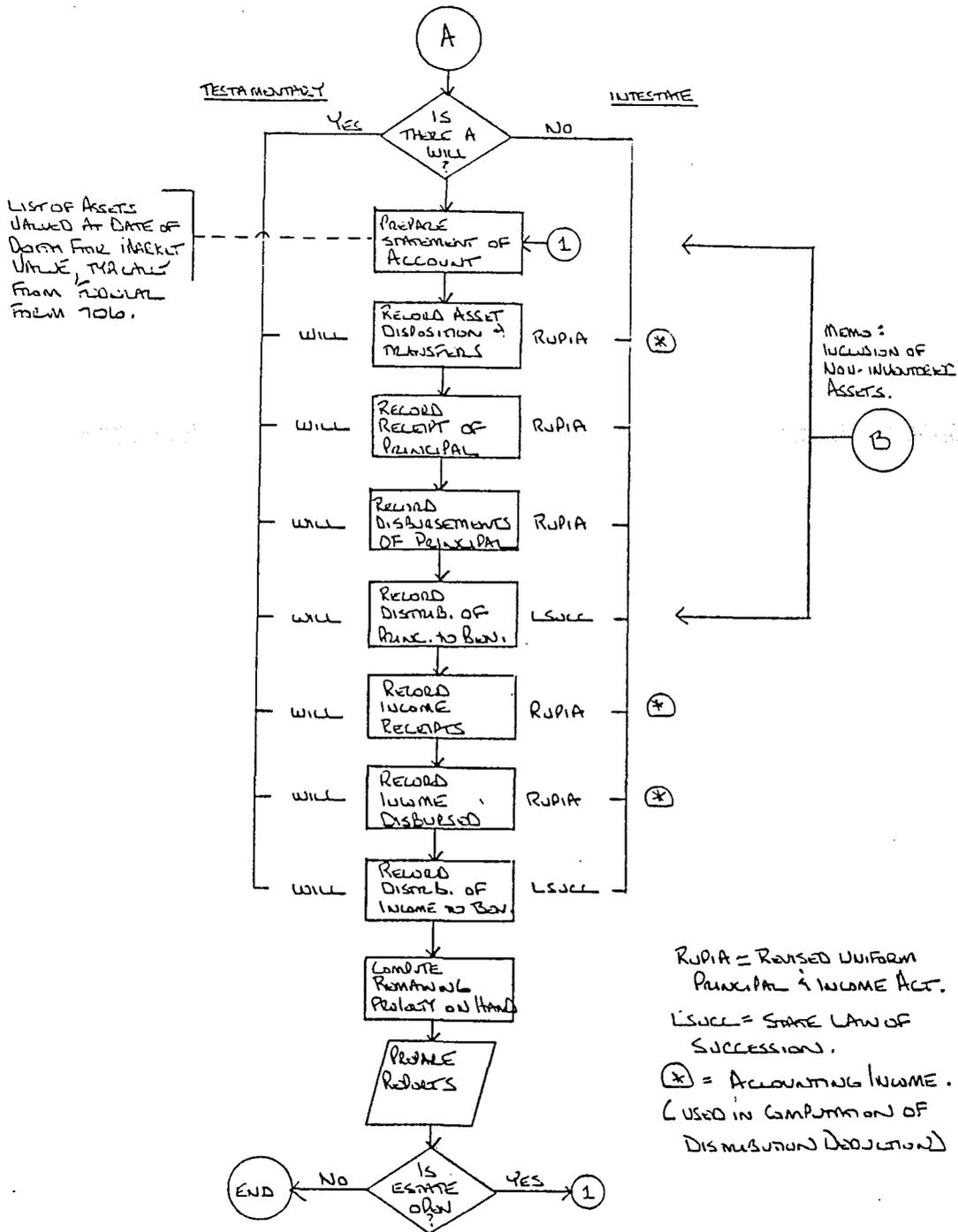
Appendix I:

Systems Flow Chart: Legal and Accounting.⁹

9. Flow chart of the legal and accounting aspects of the fiduciary responsibility function, as prepared by the author.

FINANCIAL ACCOUNTING





Appendix J:
Systems Flow Chart: Income Tax.¹⁰

10. Flow chart of the income tax aspect of the fiduciary responsibility function, as prepared by the author.

INCOME TAXATION

TAX CALCULATION OVERVIEW

FIDUCIARY INCOME TAX RETURN FORMAT:

INCOME:

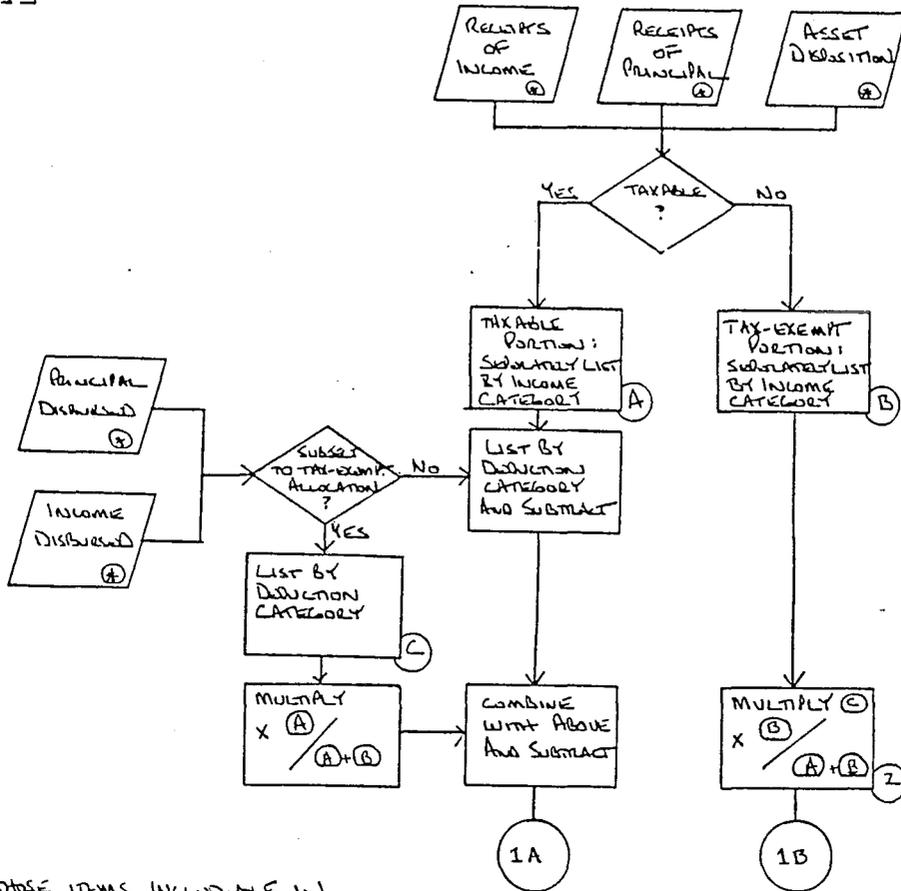
- DIVIDENDS
- INTEREST
- PARTNERSHIPS, ESTATES, TRUSTS
- NET RENT, ROYALTY
- NET BUSINESS, FARM
- CAPITAL GAINS (LOSSES)
- ORDINARY GAINS (LOSSES)
- OTHER INCOME

DEDUCTIONS:

- INTEREST
- FIDUCIARY FEES
- PROFESSIONAL FEES
- OTHER DEDUCTIONS (INCLUDING TAXES)

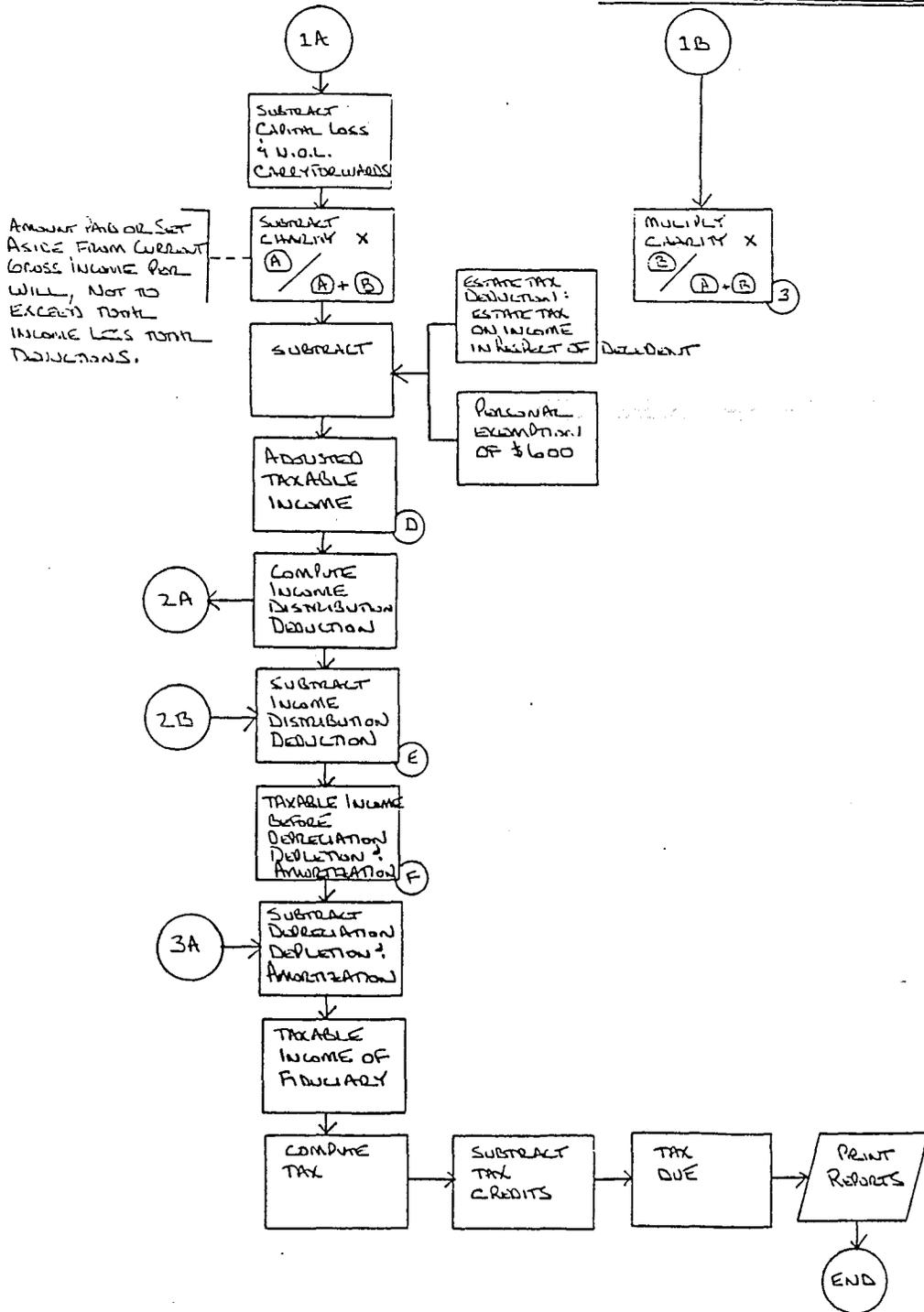
NOTE: FOR SIMPLICITY IN UNDERSTANDING THE FOLLOWING ITEMS HAVE BEEN EXCLUDED FROM THE FLOWCHART:

- (1) NO SELECTION OF INCOME/EXPENSES IN RESPECT OF A DECEDENT HAS BEEN MADE.
- (2) THE LIMITATIONS UNDER THE TAX REFORM ACT OF 1986 HAVE NOT BEEN PRESENTED.
- (3) NO LIMITATION OF THE ALTERNATIVE MINIMUM TAX INCLUDED.
- (4) ASSUMING NO SPECIAL ALLOCATIONS OF GAINS, DEDUCTIONS, OR CREDITS.
- (5) NO GAIN/LOSS ELECTION BY FIDUCIARY ON DISTRIBUTION OF ASSETS TO BENEFICIARIES.

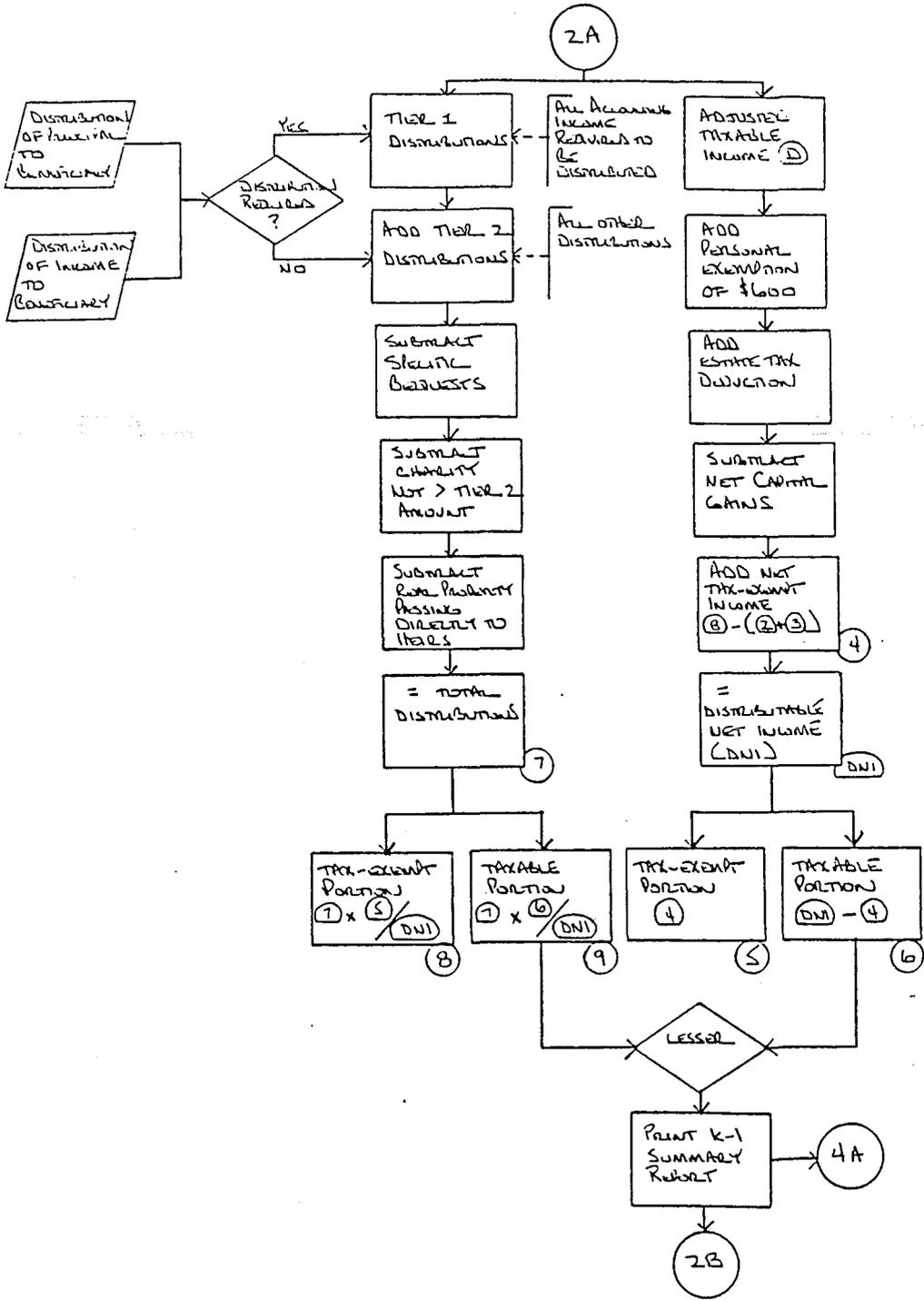


(A) ONLY THOSE ITEMS INCLUDEABLE IN TAX RETURN, DETERMINED IN MANNER SAME AS INDIVIDUAL.

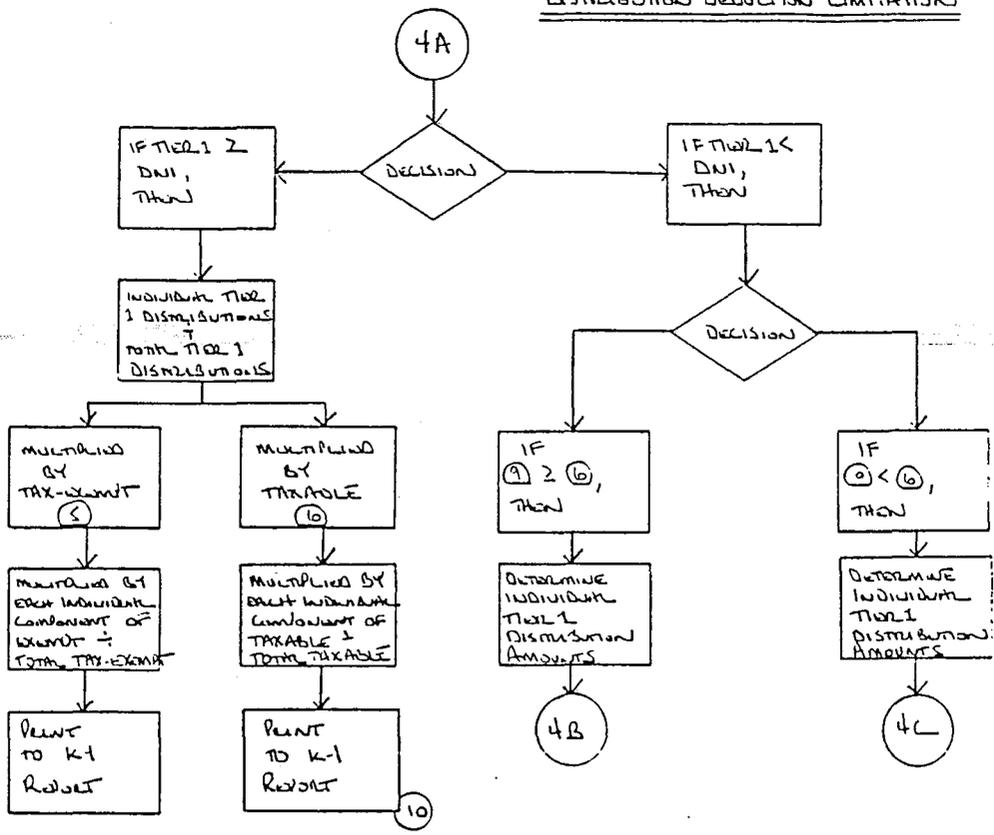
TAX CALCULATION SUBVIEW (CONT.)



Distribution Deduction

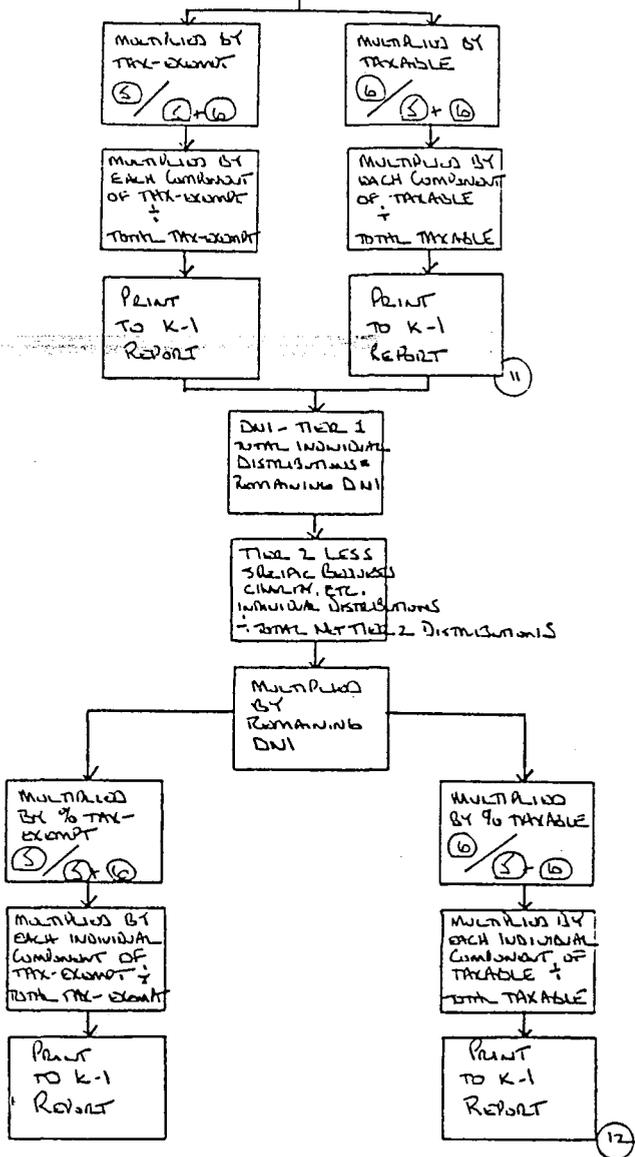


DISTRIBUTION DEDUCTION LIMITATION



DISTRIBUTION DEDUCTION LIMITATIONS
(CONT.)

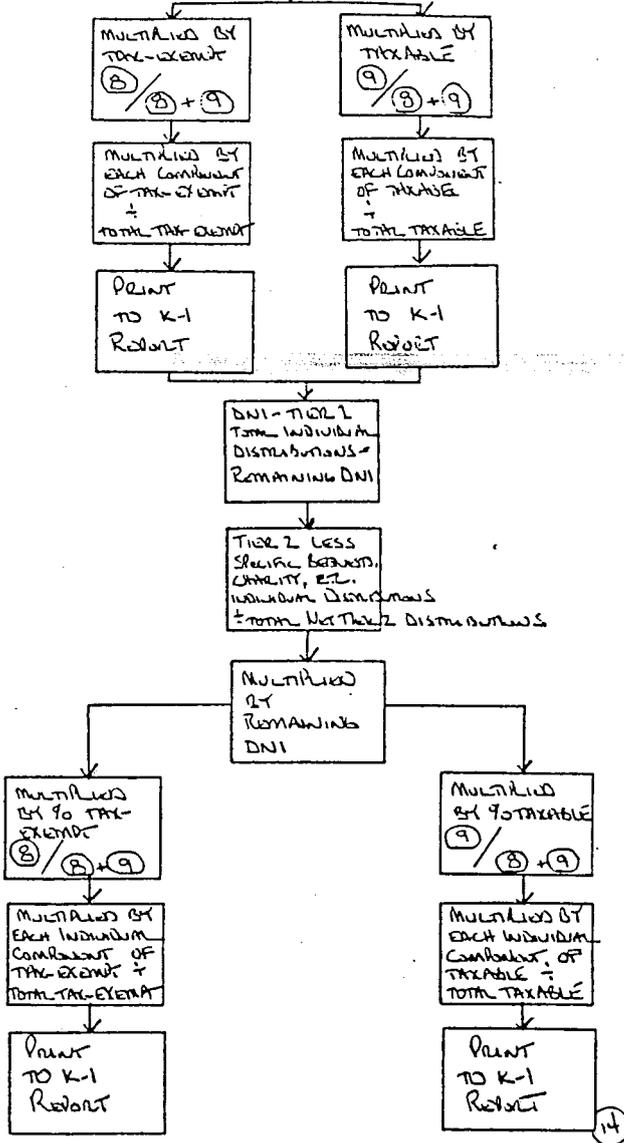
4B



DISTRIBUTION DEDUCTION LIMITATION

(Cont.)

4c



14

DEPRECIATION, DEPLETION & AMORTIZATION

