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### Excess Estate Expenses can be Windfall to Beneficiary

July 12, 2011 by Deirdre Wheatley-Liss



Who would have thought it, but the 1041 income tax return for an estate could make the beneficiaries money.

Many times an estate may have deductions in excess of its income. An estate's income would include any items of income earned by the estate from the time of the decedent's death until the time that the estate is closed and a final income tax return is filed. These items of income are reflected on a United States Income Tax Return for Estates and Trusts ([IRS Form 1041](#)).

An Executor must file an income tax return for an estate (i.e. IRS Form 1041) each tax year for the estate where it has gross income of \$600 or more or as a beneficiary who is a non-resident alien. The return is due April 15, like a personal income tax return.

**There may be situations where an estate does not have significant income, but has significant deductions.** The Executor has a choice of deducting certain estate administration expenses or losses on either the estate tax return ([Form 706](#)), or the estate's income tax return (Form 1041). In a situation where it is not a taxable estate (for example, all assets are passing to the spouse, and there is an unlimited marital deduction) it doesn't necessarily make sense to reflect the estate administration expenses on the estate tax return; **there is more value to the beneficiaries of the estate than having those expenses reflected on the estates income tax return** (Form 1041). By being reflected on the return, these expenses and losses can (1) be used to shelter any income earned by the estate during the time that the estate is open, and (2) potentially flow to the beneficiaries upon the filing of a final estate income tax return, Form 1041, in the final year for filing the return.

You cannot claim the estate administration and other expenses of losses on both returns – if a deduction is claimed for income tax purposes on the 1041, the Executor must file a statement that no estate tax deduction for those items has been allowed and waive any right to take an estate tax deduction for them.

When the estate is concluded, the estate may file a final income tax return marked as **“final.”**

The instructions to the Schedule K-1 for Form 1041 identify how a beneficiary filing a Form 1040 should report their share of income and deductions. Section 11 reflects final year deductions proportionate to each beneficiary and how it these deductions can be reflected on the beneficiary's personal 1040. The 1041 instructions specifically provide **“if the estate or trust has for its final year deductions (excluding the charitable deduction and exemption) in excess of its gross income, the excess is allowed as an itemized deduction to the beneficiary succeeding to the property of the estate or trust.”**



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Note that these deductions will be subject to any limitations and be applied to the beneficiary because of his or her taxpayer profile. **Even where an estate has no income, a 1041 should be properly filed each year in order to record the deductions and/or losses of the estate, which may, in the estate's final year be passed along, on a pro rated manner to the beneficiaries estate for utilization in their personal tax returns.**

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