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Treas. Reg. Section 1.1411-3

Application to estates and trusts

(a) Estates and trusts to which tax applies.

(1) In general.

(i) General application. Section 1411 and the regulations thereunder apply to all estates and trusts that are subject to the provisions of part I of subchapter J of chapter 1 of subtitle A of the Internal Revenue Code, unless specifically exempted under paragraph (b) of this section.

(ii) Calculation of tax. The tax imposed by section 1411(a)(2) for each taxable year is equal to 3.8 percent of the lesser of-

(A) The estate's or trust's undistributed net investment income for such taxable year; or

(B) The excess (if any) of-

(1) The estate's or trust's adjusted gross income (as defined in section 67(e) and as adjusted under §1.1411-10(e)(2), if applicable) for such taxable year; over

(2) The dollar amount at which the highest tax bracket in section 1(e) begins for such taxable year.

(2) Taxable year of less than twelve months.

(i) General rule. In the case of an estate or trust that has a taxable year consisting of less than twelve months (short taxable year), the dollar amount described in paragraph (a)(1)(ii)(B)(2) of this section is not reduced or prorated.

(ii) Change of annual accounting period. Notwithstanding paragraph (a)(2)(i) of this section, an estate or trust that has a short taxable year resulting from a change of annual accounting period (but not from an individual's death) reduces the dollar amount described in paragraph (a)(1)(ii)(B)(2) of this section to an amount that bears the same ratio to that dollar amount as the number of months in the short taxable year bears to twelve.

(3) Rules with respect to CFCs and PFICs. Additional rules in § 1.1411-10 apply to an estate or trust that holds an interest in a controlled foreign corporation (CFC) or a passive foreign investment company (PFIC).

(b) Application to certain trusts and estates.

(1) Exception for certain trusts and estates. The following trusts are not subject to the tax imposed by section 1411:

(i) A trust or decedent's estate all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2)(B).

(ii) A trust exempt from tax under section 501.

(iii) A charitable remainder trust described in section 664. However, see paragraph (d) of this section for special rules regarding the treatment of annuity or unitrust distributions from such a trust to persons subject to tax under section 1411.

(iv) Any other trust, fund, or account that is statutorily exempt from taxes imposed in subtitle A. For example, see sections 220(e)(1), 223(e)(1), 529(a), and 530(a).

(v) A trust, or a portion thereof, that is treated as a grantor trust under subpart E of part I of subchapter J of chapter 1. However, in the case of any such trust or portion thereof, each item of income or deduction that is included in computing taxable income of a grantor or another person under section 671 is treated as if it had been received by, or paid directly to, the grantor or other person for purposes of calculating such person's net investment income.

(vi) Electing Alaska Native Settlement Trusts subject to taxation under section 646.

(vii) Cemetery Perpetual Care Funds to which section 642(i) applies.

(viii) Foreign trusts (as defined in section 7701(a)(31)(B) and §301.7701-7(a)(2)) (but see §§1.1411-3(e)(3)(ii) and 1.1411-4(e)(1)(ii) for rules related to distributions from foreign trusts to United States beneficiaries).

(ix) Foreign estates (as defined in section 7701(a)(31)(A)) (but see §1.1411-3(e)(3)(ii) for rules related to distributions from foreign estates to United States beneficiaries).

(2) Special rules for certain taxable trusts and estates.

(i) Qualified funeral trusts. For purposes of the calculation of any tax imposed by section 1411, section 1411 and the regulations thereunder are applied to each qualified funeral trust (within the meaning of section 685) by treating each beneficiary's interest in each such trust as a separate trust.

(ii) Bankruptcy estates. A bankruptcy estate in which the debtor is an individual is treated as a married taxpayer filing a separate return for purposes of section 1411. See §1.1411-2(a)(2)(v) and (d)(1)(ii).

(c) Application to electing small business trusts (ESBTs).

(1) General application. The S portion and non-S portion (as defined in §1.641(c)-1(b)(2) and (3), respectively) of a trust that has made an ESBT election under section 1361(e)(3) and §1.1361-1(m)(2) are treated as separate trusts for purposes of the computation of undistributed net investment income in the manner described in paragraph (e) of this

section, but are treated as a single trust for purposes of determining the amount subject to tax under section 1411. If a grantor or another person is treated as the owner of a portion of the ESBT, the items of income and deduction attributable to the grantor portion (as defined in §1.641(c)-1(b)(1)) are included in the grantor's calculation of net investment income and are not included in the ESBT's computation of tax described in paragraph (c)(1)(ii) of this section.

(2)Computation of tax. This paragraph (c)(2) provides the method for an ESBT to compute the tax under section 1411.

(i) Step one. The S portion and non-S portion computes each portion's undistributed net investment income as separate trusts in the manner described in paragraph (e) of this section and then combine these amounts to calculate the ESBT's undistributed net investment income.

(ii) Step two. The ESBT calculates its adjusted gross income (as defined in paragraph (a)(1)(ii)(B)(1) of this section). The ESBT's adjusted gross income is the adjusted gross income of the non-S portion, increased or decreased by the net income or net loss of the S portion, after taking into account all deductions, carryovers, and loss limitations applicable to the S portion, as a single item of ordinary income (or ordinary loss).

(iii) Step three. The ESBT pays tax on the lesser of-

(A) The ESBT's total undistributed net investment income; or

(B) The excess of the ESBT's adjusted gross income (as calculated in paragraph (c)(2)(ii) of this section) over the dollar amount at which the highest tax bracket in section 1(e) begins for the taxable year.

(3)

Example.

(i) In Year 1 (a year that section 1411 is in effect), the non-S portion of Trust, an ESBT, has dividend income of \$15,000, interest income of \$10,000, and capital loss of \$5,000. Trust's S portion has net rental income of \$21,000 and a capital gain of \$7,000. The Trustee's annual fee of \$1,000 is allocated 60% to the non-S portion and 40% to the S portion. Trust makes a distribution from income to a single beneficiary of \$9,000.

(ii) Step one.

(A) Trust must compute the undistributed net investment income for the S portion and non-S portion in the manner described in paragraph (c) of this section.

The undistributed net investment income for the S portion is \$27,600 and is determined as follows:

Net Rental Income \$21,000

Capital Gain 7,000

Trustee Annual Fee (400)

Total S portion undistributed net investment income 27,600

(B) The undistributed net investment income for the non-S portion is \$12,400 and is determined as follows:

Dividend Income	\$15,000	
Interest Income	10,000	
Deductible Capital Loss	(3,000)	
Trustee Annual Fee	(600)	
Distributable net income distribution	(9,000)	
Total non-S portion undistributed net investment income		12,400

(C) Trust combines the undistributed net investment income of the S portion and non-S portion from (ii)(A) and (B) to arrive at Trust's combined undistributed net investment income.

S portion's undistributed net investment income	\$27,600	
Non-S portion's undistributed net investment income		12,400
Combined undistributed net investment income		40,000

(iii) Step two.

(A) The ESBT calculates its adjusted gross income. Pursuant to paragraph (c)(2)(ii) of this section, the ESBT's adjusted gross income is the non-S portion's adjusted gross income increased or decreased by the net income or net loss of the S portion.

(B) The adjusted gross income for the ESBT is \$40,000 and is determined as follows:

Dividend Income	\$15,000	
Interest Income	10,000	
Deductible Capital Loss	(3,000)	
Trustee Annual Fee	(600)	
Distributable net income distribution	(9,000)	
S Portion Income	27,600	
Adjusted gross income		40,000

(C) The S portion's single item of ordinary income used in the ESBT's adjusted gross income calculation is \$27,600. This item of income is determined by starting with net rental income of \$21,000 and capital gain of \$7,000 and reducing it by the S portion's \$400 share of the annual trustee fee.

(iv) Step three. Trust pays tax on the lesser of-

(A) The combined undistributed net investment income (\$40,000); or

(B) The excess of adjusted gross income (\$40,000) over the dollar amount at which the highest tax bracket in section 1(e) applicable to a trust begins for the taxable year.

(d)Application to charitable remainder trusts (CRTs).

(1)Operational rules.

(i) Treatment of annuity or unitrust distributions. If one or more items of net investment income comprise all or part of an annuity or unitrust distribution from

a CRT, such items retain their character as net investment income in the hands of the recipient of that annuity or unitrust distribution.

(ii) Apportionment among multiple beneficiaries. In the case of a CRT with more than one annuity or unitrust beneficiary, the net investment income is apportioned among such beneficiaries based on their respective shares of the total annuity or unitrust amount paid by the CRT for that taxable year.

(iii) Accumulated net investment income. The accumulated net investment income of a CRT is the total amount of net investment income received by a CRT for all taxable years that begin after December 31, 2012, less the total amount of net investment income distributed for all prior taxable years of the trust that begin after December 31, 2012.

(2) Application of Section 664.

(i) General rule. The Federal income tax rate of the item of net investment income, to be used to determine the proper classification of that item within the appropriate income category as described in §1.664-1(d)(1)(i)(b), is the sum of the income tax rate applicable to that item under chapter 1 and the tax rate under section 1411. Thus, the accumulated net investment income and excluded income (as defined in §1.1411-1(d)(4)) of a CRT in the same income category constitute separate classes of income within that category as described in §1.664-1(d)(1)(i)(b).

(ii) Special rules for CRTs with income from CFCs or PFICs. [Reserved]

(iii) Examples. The following examples illustrate the provisions of this paragraph (d)(2).

Example (1).

(i) In 2009, A formed CRT as a charitable remainder annuity trust. The trust document requires an annual annuity payment of \$50,000 to A for 15 years. For purposes of this example, assume that CRT is a valid charitable remainder trust under section 664 and has not received any unrelated business taxable income during any taxable year.

(ii) As of January 1, 2013, CRT has the following items of undistributed income within its §1.664-1(d)(1) categories and classes:

Category Class	Tax rate (percent)	Amount		
Ordinary Income	Interest 39.6	\$4,000		
	Net Rental Income 39.6	8,000		
	Non-Qualified Dividend Income		39.6	2,000
	Qualified Dividend Income	20.0		10,000
Capital Gain	Short-Term 39.6	39,000		
	Unrecaptured Section 1250 Gain		25.0	1,000
	Long-Term 20.0	560,000		
Other Income	.....			None
Total undistributed income as of January 1, 2013	.....			624,000

Pursuant to §1.1411-3(d)(1)(iii), none of the \$624,000 of undistributed income is accumulated net investment income (ANII) because none of it was received by CRT after December 31, 2012. Thus, the entire \$624,000 of undistributed income is excluded income (as defined in §1.1411-1(d)(4)).

(iii) During 2013, CRT receives \$7,000 of interest income, \$9,000 of qualified dividend income, \$4,000 of short-term capital gain, and \$11,000 of long-term capital gain. Prior to the 2013 distribution of \$50,000 to A, CRT has the following items of undistributed income within its §1.664-1(d)(1) categories and classes after the application of paragraph (d)(2) of this section:

Category	Class	Excluded/ANIL	Tax rate (percent)	Amount
Ordinary Income	Interest	NIL	43.4	\$7,000
	Interest	Excluded 39.6	4,000	
	Net Rental Income	Excluded 39.6	8,000	
	Non-Qualified Dividend Income	Excluded 39.6	2,000	
	Qualified Dividend Income	NIL	23.8	9,000
Capital Gain	Qualified Dividend Income	Excluded 20.0	10,000	
	Short-Term	NIL	43.4	4,000
	Short-Term	Excluded 39.6	39,000	
	Unrecaptured Section 1250 Gain	Excluded 25.0	1,000	
	Long-Term	NIL	23.8	11,000
Other Income	Long-Term	Excluded 20.0	560,000	
				None

(iv) The \$50,000 distribution to A for 2013 will include the following amounts:

Category	Class	Excluded/ANIL	Tax rate (percent)	Amount
Ordinary Income	Interest	NIL	43.4	\$7,000
	Interest	Excluded 39.6	4,000	
	Net Rental Income	Excluded 39.6	8,000	
	Non-Qualified Dividend Income	Excluded 39.6	2,000	
	Qualified Dividend Income	NIL	23.8	9,000
Capital Gain	Qualified Dividend Income	Excluded 20.0	10,000	
	Short-Term	NIL	43.4	4,000
	Short-Term	Excluded 39.6	6,000	
	Unrecaptured Section 1250 Gain	Excluded 25.0	None	
	Long-Term	NIL	23.8	None
Other Income	Long-Term	Excluded 20.0	None	

The amount included in A's 2013 net investment income is \$20,000. This amount is comprised of \$7,000 of interest income, \$9,000 of qualified dividend income, and \$4,000 of short-term capital gain.

(v) As a result, as of January 1, 2014, CRT has the following items of undistributed income within its §1.664-1(d)(1) categories and classes:

Category	Class	Excluded/ANIL	Tax rate (percent)	Amount
Ordinary Income	Interest	.....	.....	None
	Net Rental Income	.....	.....	None
	Non-Qualified Dividend Income	.....	.....	None
	Qualified Dividend Income	.....	.....	None
Capital Gain	Short-Term	Excluded 39.6	\$33,000	
	Unrecaptured Section 1250 Gain	Excluded 25.0	1,000	
	Long-Term	ANIL	23.8	11,000
	Long-Term	Excluded 20.0	560,000	
Other Income				None

Example (2). [Reserved].

(3) Elective simplified method. [Reserved]

(e) Calculation of undistributed net investment income.

(1) In general. This paragraph (e) provides special rules for the computation of certain deductions and for the allocation of net investment income between an estate or trust and its beneficiaries. Generally, an estate's or trust's net investment income is calculated in the same manner as that of an individual. See §1.1411-10(c) for special rules regarding CFCs, PFICs, and estates and trusts holding interests in such entities.

(2)Undistributed net investment income. An estate's or trust's undistributed net investment income is the estate's or trust's net investment income reduced by distributions of net investment income to beneficiaries and by deductions under section 642(c) in the manner described in paragraphs (e)(3) and (e)(4) of this section.

(3)Distributions of net investment income to beneficiaries.

(i) In computing the estate's or trust's undistributed net investment income, net investment income is reduced by distributions of net investment income made to beneficiaries. The deduction allowed under this paragraph (e)(3) is limited to the lesser of the amount deductible to the estate or trust under section 651 or section 661, as applicable, or the net investment income of the estate or trust. In the case of a deduction under section 651 or section 661 that consists of both net investment income and excluded income (as defined in §1.1411-1(d)(4)), the distribution must be allocated between net investment income and excluded income in a manner similar to §1.661(b)-1 as if net investment income constituted gross income and excluded income constituted amounts not includible in gross income. See §1.661(c)-1 and Example 1 in paragraph (e)(5) of this section.

(ii) If one or more items of net investment income comprise all or part of a distribution for which a deduction is allowed under paragraph (e)(3)(i) of this section, such items retain their character as net investment income under section 652(b) or section 662(b), as applicable, for purposes of computing net investment income of the recipient of the distribution who is subject to tax under section 1411. The provisions of this paragraph (e)(3)(ii) also apply to distributions to United States beneficiaries of current year income described in section 652 or section 662, as applicable, from foreign estates and foreign nongrantor trusts.

(4)Deduction for amounts paid or permanently set aside for a charitable purpose. In computing the estate's or trust's undistributed net investment income, the estate or trust is allowed a deduction for amounts of net investment income that are allocated to amounts allowable under section 642(c). In the case of an estate or trust that has items of income consisting of both net investment income and excluded income, the allowable deduction under this paragraph (e)(4) must be allocated between net investment income and excluded income in accordance with §1.642(c)-2(b) as if net investment income constituted gross income and excluded income constituted amounts not includible in gross income. For an estate or trust with deductions under both sections 642(c) and 661, see §1.662(b)-2 and Example 2 in paragraph (e)(5) of this section.

(5)Examples. The following examples illustrate the provisions of this paragraph (e). In each example, Year 1 is a year in which section 1411 is in effect and the taxpayer is not a foreign estate or trust:

Example (1). Calculation of undistributed net investment income (with no deduction under section 642(c)).

(i) In Year 1, Trust has dividend income of \$15,000, interest income of \$10,000, capital gain of \$5,000, and \$75,000 of taxable income relating to a distribution from an individual retirement account (as defined under section 408). Trust has no expenses. Trust distributes \$10,000 of its current year trust accounting income to A, a beneficiary of Trust.

(ii) Trust's distributable net income is \$100,000 (\$15,000 in dividends plus \$10,000 in interest plus \$75,000 of taxable income from an individual retirement account), from which the \$10,000 distribution to A is paid. Trust's deduction under section 661 is \$10,000. Under §1.662(b)-1, the deduction reduces each class of income comprising distributable net income on a proportional basis. The \$10,000 distribution equals 10% of distributable net income (\$10,000 divided by \$100,000). Therefore, the distribution consists of dividend income of \$1,500, interest income of \$1,000, and ordinary income attributable to the individual retirement account of \$7,500. Because the \$5,000 of capital gain allocated to principal for trust accounting purposes did not enter into distributable net income, no portion of that amount is included in the \$10,000 distribution, nor does it qualify for the deduction under section 661.

(iii) Trust's net investment income is \$30,000 (\$15,000 in dividends plus \$10,000 in interest plus \$5,000 in capital gain). Trust's \$75,000 of taxable income attributable to the individual retirement account is excluded income under §1.1411-1(d)(4). Trust's undistributed net investment income under paragraph (e)(2) of this section is \$27,500, which is Trust's net investment income (\$30,000) less the amount of dividend income (\$1,500) and interest income (\$1,000) distributed to A. The \$27,500 of undistributed net investment income is comprised of the capital gain allocated to principal (\$5,000), the remaining undistributed dividend income (\$13,500), and the remaining undistributed interest income (\$9,000).

(iv) Under paragraph (e)(3) of this section and pursuant to §1.1411-4(a)(1), A's net investment income includes dividend income of \$1,500 and interest income of \$1,000, but does not include the \$7,500 of ordinary income attributable to the individual retirement account because it is excluded from net investment income under §1.1411-8. Example (2). Calculation of undistributed net investment income (with deduction under section 642(c)).

(i) Same facts as Example 1, except Trust is required to distribute \$30,000 to A. In addition, Trust has a \$10,000 deduction under section 642(c) (deduction for amounts paid for a charitable purpose). Trust also makes an additional discretionary distribution of \$20,000 to B, a beneficiary of Trust. As in Example 1, Trust's net investment income is \$30,000 (\$15,000 in dividends plus \$10,000 in interest plus \$5,000 in capital gain). In accordance with §§1.661(b)-2 and 1.662(b)-2, the items of income must be allocated between the mandatory distribution to A, the discretionary distribution to B, and the \$10,000 distribution to a charity.

(ii) For purposes of the mandatory distribution to A, Trust's distributable net income is \$100,000. See §1.662(b)-2, Example 1(b). Trust's deduction under section 661 for the distribution to A is \$30,000. Under §1.662(b)-1, the deduction reduces each class of income comprising distributable net income on a proportional basis. The \$30,000 distribution equals 30% of distributable net income (\$30,000 divided by \$100,000). Therefore, the distribution consists of dividend income of \$4,500, interest income of \$3,000, and ordinary income attributable to the individual retirement account of \$22,500. A's mandatory distribution thus consists of \$7,500 of net investment income and \$22,500 of excluded income.

(iii) Trust's remaining distributable net income is \$70,000. Trust's remaining undistributed net investment income is \$22,500. The \$10,000 deduction under section 642(c) is allocated in the same manner as the distribution to A, where the \$10,000 distribution equals 10% of distributable net income (\$10,000 divided by \$100,000). For purposes of determining undistributed net investment income, Trust's net investment income is reduced by \$2,500 under paragraph (e)(4) of this section (dividend income of

\$1,500, interest income of \$1,000, but with no reduction for amounts attributable to the individual retirement account of \$7,500).

(iv) With respect to the discretionary distribution to B, Trust's remaining distributable net income is \$60,000. Trust's remaining undistributed net investment income is \$20,000. Trust's deduction under section 661 for the distribution to B is \$20,000. The \$20,000 distribution equals 20% of distributable net income (\$20,000 divided by \$100,000). Therefore, the distribution consists of dividend income of \$3,000, interest income of \$2,000, and ordinary income attributable to the individual retirement account of \$15,000. B's distribution consists of \$5,000 of net investment income and \$15,000 of excluded income.

(v) Trust's undistributed net investment income is \$15,000 after taking into account distribution deductions and section 642(c) in accordance with paragraphs (e)(3) and (e)(4) of this section, respectively. To arrive at Trust's undistributed net investment income of \$15,000, Trust's net investment income of \$30,000 is reduced by \$7,500 of the mandatory distribution to A, \$2,500 of the section 642(c) deduction, and \$5,000 of the discretionary distribution to B. The undistributed net investment income consists of the remaining dividend income of \$6,000 (\$15,000 less \$4,500 less \$1,500 less \$3,000), interest income of \$4,000 (\$10,000 less \$1,000 less \$3,000 less \$2,000), and the \$5,000 of undistributed capital gain.

Example (3). Fiscal Year Estate.

(i) D died in 2011. D's estate (Estate) filed its first return that established its fiscal year ending October 31, 2011. During Estate's fiscal year ending October 31, 2013, it earned \$10,000 of interest, \$1,000 of dividends, and \$15,000 of short-term gains. The Estate distributed its interest and dividends to S, D's spouse and sole beneficiary, on a quarterly basis; the last quarter's payment for that taxable year was made to S on December 5, 2013. Pursuant to §1.662(c)-1, S is deemed to have received the first three payments for that taxable year, regardless of the actual payment dates, on October 31, 2013, the last day of Estate's taxable year. Estate makes a timely section 663(b) election to treat the fourth quarter distribution to S as having been made on October 31, 2013, the last day of Estate's preceding taxable year. Accordingly, S is deemed to have received \$10,000 of interest and \$1,000 of dividends on October 31, 2013.

(ii) Because Estate's fiscal year ending October 31, 2013, began on November 1, 2012, the Estate is not subject to section 1411 on income received during that taxable year. Therefore, none of the income received by Estate during its fiscal year ending October 31, 2013, is net investment income. Pursuant to paragraph (e)(3)(ii) of this section, because none of the distributed interest or dividend income constituted net investment income to Estate, the \$10,000 of interest and \$1,000 of dividends that Estate distributed to S does not constitute net investment income to S.

(f)Effective/applicability date. This section applies to taxable years beginning after December 31, 2013, except that paragraph (d) of this section applies to taxable years of CRTs that begin after December 31, 2012. However, taxpayers other than CRTs may apply this section to taxable years beginning after December 31, 2012, in accordance with §1.1411-1(f).