📖 *Direct Sellers* starts on Page 3-15.

Decedents

Contents

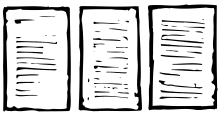
Quick Tax Briefing

Overview

Filing a return for the year an individual dies presents some unique filing and reporting rules. The decedent's final return includes income and deductions through the date of death, but certain elections, such as deducting medical costs paid after death, should be considered. It is the responsibility of the decedent's executor or personal representative to file the decedent's final Form 1040.

Tax highlights

- ✓ A decedent's tax year ends on the date of death, although the due date of the final Form 1040 return remains the same, typically April 15 of the following year.
- ✓ A joint return can be filed for a decedent and surviving spouse if the spouse has not remarried at the end of the tax year and the surviving spouse and estate representative agree to file jointly.



- ✓ The death of a partner closes the partnership's tax year for that partner but it generally does not close the partnership's tax year for the remaining partners.
- ✓ In the year of a S shareholder's death, the S corporation should prepare a separate Schedule K-1 reporting the decedent's proportionate share of the S corporation's pass-through income or loss for the portion of the corporation's tax year through the date of death (to be reported on the decedent's final Form 1040).
- ✓ Accrued, but unpaid, income as of the date of death is income in respect of a decedent (IRD). IRD is excluded from the decedent's final income tax return and taxed to the taxpayer, typically the estate or an heir, who actually or constructively collects the IRD.
- ✓ Medical costs paid from the decedent's estate within one year of the day following death can be deducted either on Schedule A of the decedent's final Form 1040 or on the estate tax return (Form 706), but not both.
- ✓ Net operating losses and capital losses allocable to the decedent cannot be carried over and used by his estate, nor can they be carried over and used in future tax years by a surviving spouse.
- ✓ A personal representative can shorten the time the IRS has to assess the decedent's estate with any additional tax from three years to 18 months by requesting a prompt assessment of the decedent's income taxes.
- ✓ If there is no court-appointed representative and no surviving spouse, Form 1310 must be attached to the return to claim a refund.

IRS materials

- Pub. 559, *Survivors, Executors, and Administrators*.
- Form 56, *Notice Concerning Fiduciary Relationship*.
- Form 1310, *Statement of Person Claiming Refund Due a Deceased Taxpayer*.
- Form 4810, *Request for Prompt Assessment Under Internal Revenue Code Section 6501(d)*.

Key Terms

Accelerated death benefits. Amounts received under a life insurance contract before the death of the insured individual. Also includes amounts received on the sale or assignment of the contract to a viatical settlement provider.

Constructive receipt. This doctrine requires a cash-basis taxpayer to recognize income when an item is credited to the taxpayer's account or made available without restriction.

Decedent. An individual who has died.

Deductions in respect of a decedent (DRD). Items, such as business expenses, income-producing expenses, interest and taxes, for which the decedent was liable but that are not properly allowable as deductions on the decedent's final income tax return, generally because they are unpaid at death.

Income in respect of a decedent (IRD). Accrued, but unpaid, income as of the date of death for decedents who were cash basis taxpayers.

Letters testamentary. Documents issued by a court to the executor that provide evidence of the executor's authority to act on behalf of the estate; without them, third parties generally will not follow the executor's instructions.

Personal representative. An executor, administrator or anyone who is in charge of the decedent's property.

Prompt assessment of tax. A request by an executor to shorten the period the IRS can assess tax on the decedent's returns from the usual three years to an 18-month period beginning the date the IRS receives the request.

Filing Requirements—Year of Death

A decedent's tax year ends on the date of death, although the due date of the final Form 1040 remains the same (typically April 15 of the following year). In general, normal tax accounting rules apply regarding the recognition of income and deductions, including the doctrine of constructive receipt. The tax year of the estate's income tax return, Form 1041, begins with the date of death and must terminate at a month-end no more than twelve months after the date of death. The estate may elect a fiscal tax year; it does not have to be a calendar year ending on December 31.

Return for preceding year. If an individual died after the close of the tax year, but before the return for that year was filed, the return for the year just closed will not be the final return. The return for that year will be a regular return, and the personal representative must file it.

Example: Eddie Jones died on March 21, 2013, before filing his 2012 tax return. His personal representative must file his 2012 return by April 15, 2013 or request an extension. Eddie's final tax return is his 2013 return (for the period January 1, 2013–March 21, 2013) and is due April 15, 2014.

Federally Declared Disasters— Summary of Special Tax Relief Provisions	
Item	**Special relief**
Casualty loss deduction	• 10%-of-AGI limit waived.[1] • Can elect to claim in year before year of the disaster.
Depreciation—50% bonus[1]	50% special (bonus) depreciation is allowed on *qualified disaster assistance property* (see *Depreciation and Section 179 Deduction* in the next column) for the year it's placed in service.
Disaster expenses[1]	Certain disaster-related expenses that are normally capitalized are deductible.
Disaster relief payments	Payments are nontaxable.
Involuntary conversions of business or income-producing property	Any tangible replacement property acquired for use in any business is treated as similar or related in service or use to the destroyed property.
Involuntary conversions of principal residence	• Replacement period is four years rather than two years. • Special rules for avoiding gain on receipt of insurance proceeds.
Net operating loss (NOL) carryback[1]	NOL attributable to disaster loss may be carried back five years and fully deductible against AMT income.
Section 179 expense[1]	Deduction limit is increased by lesser of (1) $100,000 or (2) cost of qualifying Section 179 disaster assistance property. Threshold for phaseout is increased by lesser of (1) $600,000 or (2) cost of qualifying Section 179 disaster assistance property.
Standard deduction[1]	Nonitemizers can increase their standard deduction by the amount of their disaster loss deduction (net disaster loss).
Tax deadlines	Deadlines for filing and paying taxes and making IRS contributions are often postponed.
[1] Applies only to losses arising from disasters declared after 2007 and occurring before 2010.	

Federally Declared Disaster

A *federally declared disaster* is a disaster that occurs in an area directed by the President to be eligible for federal assistance under the Robert T. Stafford Disaster Relief and Emergency Assistance Act [IRC §165(i)(3)]. It includes a major disaster or emergency declaration under the Act. A *disaster area* is the area determined to warrant such assistance.

See the *2012 Federally Declared Disaster Areas* table on Page 4-19.

Casualty Loss—Election to Deduct in the Prior Year

A casualty loss attributable to a federally declared disaster can be claimed in the year the disaster occurred or in the year preceding the loss on a timely return or amended return (Form 1040X) [IRC §165(i)]. This may increase the tax savings from the loss and entitle the taxpayer to a refund earlier than if he waited to claim it on the loss year's return. If a taxpayer owns multiple properties that are damaged by a federally declared disaster, he must report all losses from that disaster together, either in the year of the disaster or in the prior year. [Reg. §1.165-11(d)]

Practice Tip: Determining the most beneficial year to claim the loss requires a careful evaluation of the taxpayer's entire tax picture for both years, including filing status, amount of income and other deductions, and the applicable tax rates. For example, claiming the loss in the higher income year may not be the most advantageous approach.

Election statement. To claim the disaster loss in the year preceding the loss, an election statement must be attached to the original or amended tax return for that year. The statement should specify the date the disaster occurred and the city or town, county and state where the damaged or destroyed property was located when the disaster occurred. Indicate that the loss is being claimed in the year preceding the disaster.

Election to Deduct Disaster Loss in Previous Tax Year Under Reg. §1.165-11

The taxpayer hereby elects under IRC Sec. 165(i) to deduct the casualty loss in the amount of $ _____ and occurring on [date] in the tax year ended [tax year end], which is the year prior to the year of loss. The property that was damaged or destroyed was located in [city or town, county and state] at the time of the disaster.

An election to claim the casualty loss in the preceding year must be made by the later of:

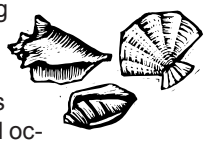
- The due date (without extensions) for filing the tax return for the tax year in which the disaster actually occurred.
- The due date (with extensions) for filing the return for the preceding tax year.

Example: In 2012, Felix incurred a casualty loss related to a federally declared disaster. He has until April 15, 2013 to amend his 2011 return and make the election to claim the loss on the preceding year return.

Casualty Loss—Waiver of 10%-of-AGI Limit

The 10%-of-AGI limit on personal casualty losses is waived for net disaster losses [IRC §165(h)]. A *net disaster loss* is equal to:

a) Personal casualty losses attributable to a federally declared disaster occurring before 2010, and occurring in a disaster area, *minus*
b) Personal casualty gains.



Note: The waiver only applies to losses arising from disasters declared after 2007 and occurring before 2010.

Depreciation and Section 179 Deduction

50% special depreciation. 50% special depreciation is allowed on qualified disaster assistance property in the year it is placed in service. Property for which the 50% special depreciation allowance is claimed is not subject to AMT depreciation adjustments for its entire recovery period. Taxpayers can elect out of the 50% special depreciation. [IRC §168(n)]

Qualified disaster assistance property. The property must meet all of the following requirements:

1) It is tangible MACRS property with a recovery period of 20 years or less, off-the-shelf computer software, water utility property, qualified leasehold improvement property, nonresidential real property or residential rental property.
2) It is purchased on or after the applicable disaster date.
3) It replaces or rehabilitates property that was damaged, destroyed or condemned as a result of a federally declared disaster that was declared after 2007 and occurred before 2010.
4) It is placed in service by the end of the third calendar year following the applicable disaster date (fourth year if nonresidential real property or residential rental property). For 2012, only property related to a disaster in 2009 (2008 or 2009 if nonresidential real property or residential rental property) would qualify.
5) The property must be used at least 80% for the active conduct of a trade or business in the disaster area.
6) The property's first use in the disaster area must begin with the taxpayer.

Note: Property used in connection with any private or commercial golf course, country club, massage parlor, hot tub facility,

Month	Full foreign days	
Sep. 2012	6	(# of days needed in Sep. to reach 330)
Oct. 2012	31	
Nov. 2012	30	
Dec. 2012	31	
Jan. 2013	31	
Feb. 2013	28	
Mar. 2013	31	
Apr. 2013	5	
May 2013	31	
Jun. 2013	30	
Jul. 2013	31	
Aug. 2013	31	
Sep. 2013	14	(Sep. 15 is not a full day)
Total	330	

As this example demonstrates, under the PPT, Fred can begin his exclusion period before his first date of arrival in the foreign country and end it after his date of departure. In 2012, he can now claim $93,293 ($^{359}/_{366}$ × $95,100) of exclusion, rather than only $91,201 ($^{351}/_{366}$ × $95,100) of exclusion. He will receive a similar increase in 2013.

Observation: The PPT will increase the foreign earned income exclusion only in a year the expatriate begins or ends the assignment. If the expatriate is overseas the full year, he will receive the maximum annual exclusion.

Waiver of time requirements. Both the bona fide residence test and the physical presence test contain minimum time requirements. The IRS can waive the minimum time requirements if the taxpayer must leave the foreign country because of war, civil unrest or similar adverse conditions in that country [Reg. §1.911-2(f)]. The taxpayer must be able to show that he could have expected to meet the minimum time requirements if not for the adverse conditions. Early each year, the IRS publishes a Revenue Procedure listing the countries and effective dates that qualify for the waiver in the preceding year. (See Rev. Proc. 2012-21 for example.)

Foreign Earned Income Exclusion

The foreign earned income exclusion (FEIE) is available to qualified expatriates with foreign earned income. The maximum exclusion available for each year is adjusted annually for inflation. For 2012, the amount is $95,100. (Rev. Proc. 2011-52)

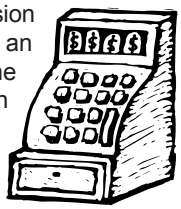
The expatriate may exclude the lesser of his foreign earned income (less any foreign housing exclusion claimed) or the maximum exclusion of $95,100 (for 2012). The income must be earned in the year for which the exclusion is being claimed and received in the tax year for which the return is being filed. Each spouse is eligible for his own exclusion. Unused exclusion from one spouse may not be used by the other spouse.

Income earned and received in 2012. This income will be eligible for the 2012 exclusion amount, which will be reported with the 2012 tax return.

Income earned in 2011 and received in 2012. This income will be eligible for the 2011 exclusion of $92,900 if the full amount was not previously claimed on an earlier return. The income and exclusion will both be reported on the 2012 tax return.

Income earned in 2012 but not received until 2013. This income will be eligible for the 2012 exclusion of $95,100 if the full exclusion was not claimed on the 2012 return. The income and exclusion will be reported on the 2013 tax return.

Income earned in 2013 but received in 2012. When filing the original 2012 return, this amount will not be eligible for the exclusion. If the expatriate is eligible for exclusion on the 2013 return, but does not fully utilize it, an amended return for 2012 may be filed to claim the additional 2013 exclusion. This amended return should be prepared in conjunction with the 2013 return in order to make sure the appropriate foreign tax credit carryover, as well as any other tax carryforwards, is included on the 2013 return.



If income related to 2012 is received prior to 2011 or after 2013, it will not be eligible for the foreign earned income exclusion.

The foreign earned income exclusion is prorated for partial years. The *2012 Foreign Earned Income Exclusion Worksheet* below may be used to compute the excludible amount.

2012 Foreign Earned Income Exclusion Worksheet		
1) Maximum exclusion	1)	$ 95,100
2) Number of days in qualifying period	2)	
3) Line 2 divided by 366 (to three places)	3)	
4) Multiply line 1 by line 3	4)	
5) 2012 qualifying foreign source earned income	5)	
6) Foreign housing exclusion claimed (line 11 from *Foreign Housing Exclusion Worksheet* on Page 6-5)	6)	
7) Subtract line 5 from line 4	7)	
8) Lesser of line 4 or line 7. This is the taxpayer's foreign earned income exclusion	8)	

Earned income is pay for personal services performed, such as wages, salaries or professional fees. The following table classifies many types of income:

Earned Income	Unearned Income	Variable Income[1]
Salaries and wages Commissions Bonuses Professional fees Tips Noncash allowances Expatriate allowances, including employer-paid housing	Dividends and Interest Capital gains Gambling winnings Alimony Social security benefits Pensions Annuities	Business profits including self-employment and partnerships Royalties Rents Scholarships and fellowships

[1] Income that may fall into either the earned income category, the unearned income category or partly into both.

Foreign Housing Exclusion

If the taxpayer meets the requirements discussed under *Qualifying for the Expatriate Tax Provisions* on Page 6-2 and is an employee, he may elect to claim the foreign housing exclusion. This exclusion is computed before claiming the foreign earned income exclusion. The exclusion applies only to amounts considered paid with employer-provided amounts.

If both spouses qualify as expatriates and share a dwelling, only one spouse can claim the foreign housing exclusion. The couple may choose which spouse will claim the exclusion, based on the best overall tax result. If the spouses live separately, then each spouse will need to claim his own housing exclusion. Additionally, if only one spouse is employed, but the non-working spouse lives in a separate foreign residence because of adverse living conditions in the working spouse's assignment location, expenses from both households will qualify for the housing exclusion.