

PENNSYLVANIA PERSONAL INCOME TAX GUIDE

CHAPTER 14: ESTATES, TRUSTS AND DECEDENTS

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CHAPTER 14: ESTATES, TRUSTS AND DECEDENTS

I. PENNSYLVANIA ESTATES AND TRUSTS

A. Overview

The Tax Reform Code of 1971 as amended defines net gains or income derived through estates or trusts as a separate Pennsylvania class of income. See 72 PA C.S. Section 7303(a)(8). Therefore, income that is distributed from an estate or trust to a trust beneficiary should be reported by the beneficiary as net income derived through estates or trusts. An estate or trust is not a pass-through entity like a partnership or S corporation. Consequently, the estate or trust should **not** classify its distributions as if they retained the same income classification as received by the estate or trust. Further, the estate or trust should **not** provide federal Schedules K-1 for Pennsylvania purposes. A federal Schedule K-1 may be accepted from a nonresident trust that has a Pennsylvania beneficiary but no Pennsylvania source income.

The income of a beneficiary of an estate or trust in respect of such estate or trust shall consist of that part of the income or gains received by the estate or trust for its taxable year ending within or with the beneficiary's taxable year which, under the governing instrument and applicable state law, is required to be distributed currently or is in fact paid or credited to said beneficiary. The income or gains of the estate or trust, if any, taxable to such estate or trust shall consist of the income or gains received by it that is not required to be distributed currently and has not been distributed or credited to its beneficiaries.

An estate or trust reports Pennsylvania-taxable income to its beneficiaries on *PA-41 Schedule L* (for tax years beginning prior to Jan. 1, 2005) and *PA-41 Schedule RK-1* or *PA-41 Schedule NRK-1* (for tax years beginning on or after Jan. 1, 2005).¹ The estate or trust reports to each beneficiary the total Pennsylvania-taxable income that it must distribute, pay or credit to each beneficiary.

In order for an estate or trust to determine its total taxable income for the taxable year, it must classify and report its income (loss) on the *PA-41 Fiduciary Income Tax Return*, just as individuals, partnerships and PA S corporations must classify and report their income (loss) on their returns. However, unlike partners or shareholders of partnerships and PA S corporations who are required to recognize their share of income (loss) in each applicable class of income received by the partnership or corporation for its taxable year ending within or with the partners' or shareholders' taxable years, the beneficiaries of an estate or trust are required to recognize whatever part of the estate's or trust's total taxable income that is allocable to them, whether distributed or required to be distributed, as net gains or income derived through estates or trusts.

¹ Beginning on or after Jan. 1, 2005, the department eliminated PA-41 Schedule L, Beneficiaries Share of Income and replaced it with PA-41 Schedule RK-1, Resident Schedule of PA S Shareholder/Partner/Beneficiary Pass Through Income, Loss and Credits and with PA-41 Schedule NRK-1, Nonresident Schedule of PA S Shareholder/Partner/Beneficiary Pass Through Income, Loss and Credits.

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B. Estate

1. Overview

An estate is an artificial entity that comes into being as the result of the death of an individual and consists of the property that the decedent owns upon his or her death. An estate for Pennsylvania purposes does not include the estates of living incompetents, bankrupts or insolvents.

2. Resident Estate

Pursuant to 72 PA C.S. Section 7301(r) a resident estate means the estate of a decedent who at the time of his death was a resident individual in Pennsylvania. The single controlling factor in determining if an estate is a resident estate shall be whether the decedent was a Pennsylvania resident individual at the time of his death. See 61 PA Code Section 101.1. The residences of the fiduciary and the beneficiaries of the estate are immaterial. See 61 PA Code Section 101.1.

3. Nonresident Estate

Pursuant to 72 PA C.S. Section 7301(n) a nonresident estate means any decedent's estate that is not a resident estate of Pennsylvania.

C. Trust and Settlor

1. Overview

For Pennsylvania personal income tax purposes, a trust includes a taxable trust created by a will and any taxable irrevocable express trust taking effect during the lifetime or after the death of the settlor.

A trust for Pennsylvania personal income tax purposes does not include:

- a. A settlor-revocable trust (see grantor trusts and settlor-revocable trusts on the pages following)
- b. A charitable trust (see charitable trust on the pages following)
- c. A resulting or constructive trust created by operation of law
- d. A trust created exclusively for the benefit of creditors
- e. A principal and agent relationship
- f. A business trust or real estate investment trust
- g. A trust created exclusively for the benefit of employees, their families, or appointees under an employee benefit plan

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- h. A pension trust or profit-sharing trust
- i. A trust that is a common trust fund for federal income tax purposes
- j. A trust created by an entity or enterprise other than a Pennsylvania personal income tax taxpayer:
 - No part of the income or corpus of which may possibly benefit any beneficiary who is a Pennsylvania personal income tax taxpayer; and
 - No part of the property of which consists of property transferred to it (or another trust) by any Pennsylvania personal income tax taxpayer.

A Pennsylvania personal income tax taxpayer means any individual, estate, trust, partnership or PA S corporation.

- k. A trust for the benefit of corporate shareholders established to complete the liquidation of a corporation (see liquidating trusts on the pages following).
- l. Qualified settlement funds and other trusts that are treated as corporations or partnerships for federal income tax purposes.
- m. Nuclear power plant decommissioning trusts (see nuclear power plant decommissioning trust below).
- n. Pre-need funeral trusts or cemetery merchandise trusts (see funeral trusts or cemetery merchandise trusts on the pages following).

2. Resident Trust

A resident trust is any of the following:

- a. Its settlor (or any of its settlors) was a Pennsylvania resident at the time the trust was created; or
- b. All through its taxable year, it consists in whole or in part of real or personal property transferred to it or to another trust by a settlor or other individual, estate or trust that at the time of the transfer was a Pennsylvania resident; or
- c. It was created by the will of a decedent who, at the time of his death, was a Pennsylvania resident.

The regulations under 61 PA Code Section 101.1 provide that the single controlling factor in determining if a trust is a resident trust for Pennsylvania purposes is whether the decedent, the person creating the trust, or the person

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transferring the property was a Pennsylvania resident individual or person at the time of death, creation of the trust, or the transfer of the property. The residences of the fiduciary and the beneficiaries of the trust are immaterial.

3. Nonresident Trust

A nonresident trust must satisfy both of the following conditions:

- a. Its settlor (or each of its settlors) was a nonresident of Pennsylvania at the time the trust was created or it was created by the will of a decedent who at the time of his death was a nonresident; and
- b. For *any* portion of the taxable year, it consists in no part of real or personal property transferred to it or to another trust by a settlor or other individual, estate or trust that at the time of the transfer was a Pennsylvania resident.

D. Charitable Trust

A charitable trust is one operated **exclusively** for religious, charitable, scientific, literary, or educational purposes. A trust is a charitable trust only if all of the net earnings for the taxable year and remaining life of the trust are for distribution for such purposes. No part of the earnings of a charitable trust may benefit any beneficiary who is a private individual.

Federally qualified charitable remainder annuity trusts (CRAT) and charitable remainder unitrusts (CRUT) are **not** Pennsylvania charitable trusts if, during the current taxable year:

1. Any part of the trust's retained earnings may benefit any private individual in subsequent years; or
2. Any part of the trust's income is required to be currently distributed or is distributed or credited to any private individual.

Trusts for the general care, maintenance, or improvement of public or church cemeteries are charitable trusts. However trusts for the care, maintenance or improvement of the burial lots of the settlor, testator or his or her family are not charitable trusts.

E. Grantor Trusts and Revocable Trusts

Pennsylvania law differs from federal law regarding grantor trusts. For federal purposes, under certain conditions, the grantor or person who has substantial dominion or control over the trust income or *corpus*, rather than the trust or its beneficiaries, reports the income.

Grantor trusts other than settlor-revocable trusts are required to file the *PA-41, Fiduciary Income Tax Return*. The beneficiaries of the trust are taxed on income

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required to be distributed currently or actually distributed or credited to them. The grantor trust is taxable on the remainder.

These federal rules are inapplicable for Pennsylvania fiduciary income tax purposes. Pennsylvania law imposes the fiduciary income tax on grantor trusts according to the same Pennsylvania personal income tax rules that apply to irrevocable trusts unless the grantor trust is a revocable trust.

A Settlor-Revocable Trust is:

1. A tentative or *Totten* trust; or
2. An express trust when the governing instrument reserves in the settlor:
 - a. The power to revoke the trust as an entirety without the declaration of new uses or the consent of any other party; and
 - b. The concurrent power to revest in himself or herself legal title to the *corpus* of the trust without the consent of any other party.

A taxpayer (settlor) that establishes a revocable trust does not file a *PA-41 Fiduciary Income Tax Return*. In this case, the taxpayer reports the income (loss) in the appropriate income class or classes on his, her or its own *PA-40 Individual Income Tax Return*.

The term settlor includes either of the following:

- a. An individual, estate or trust that is possessed of the legal title to an asset who creates a trust either by a declaration that such individual, estate or trust holds the asset in trust or by a transfer of the legal title thereto to a trustee expressly upon a trust.
- b. An individual, estate or trust that furnishes the consideration for the creation of a trust, even though in form the trust is created by another.

The term does not include any individual, estate or trust that merely transfers assets to an existing trust created and funded by another.

II. DECEDENT'S LAST INCOME TAX RETURN

A. Filing the Final Return

The decedent's final *PA-40, Individual Income Tax Return*, covers the tax year ending with the date of his or her death. The tax return for an individual who died during the tax year must be filed as deceased by the executor, administrator, or other person

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charged with caring for the decedent's property. Any return filed for a deceased individual must show the date of death on the appropriate line.

The personal representative must file a Pennsylvania tax return for a decedent if:

1. The decedent received total Pennsylvania gross taxable income in excess of \$33 during the year of death, even if no tax is due with his or her Pennsylvania return; and/or
2. The decedent incurred a loss from any transaction as an individual, sole proprietor, partner in a partnership, PA S corporation shareholder, or association member.

The personal representative must file two income tax returns when an individual dies after the close of the tax year but before the return for that year is filed. The personal representative must file the return for the year before death and the final return for the year in which death occurred. The return for the year before death is considered a regular return.

B. No Joint Returns with Surviving Spouse

Joint returns between a surviving spouse and a deceased spouse are not permitted. If the deceased was married at the time of death, the surviving spouse must file a separate return as "single" unless he or she remarries before the end of the taxable year.

Jointly owned income, such as interest, must be properly allocated between the decedent and the survivor from the beginning of the tax year to date of death. After the date of death all taxable income derived from jointly held property is attributed to the surviving owner.

C. Signing the Final Income Tax Return

The tax return for an individual who died during the tax year must be signed by the executor, administrator, or other person charged with caring for the decedent's property as representative of the estate of the decedent, *i.e.*, Jane Doe, Executrix of the Estate of John Smith, Deceased.

D. Due Date of Return

If the decedent was a calendar-year filer, the final return must be filed before midnight on April 15 including an extension date of Sept. 15 in the year following the decedent's death. If the decedent was a fiscal-year filer, the final return is due on or before the 15th day of the fourth month including an extension date of five months after the 15th day of the fourth month following the close of the decedent's fiscal year. The U.S. Postal Service postmark date on the envelope is proof of timely filing. If you do not file your return by the due date or extended due date and do not pay the tax due by the original due date, the department imposes late filing and underpayment penalties.

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E. Amounts Taxable to Decedent, Estate or Survivors

1. Federal Rules for Income in Respect of Decedent Not Controlling

Pennsylvania has no rule similar to that for federal income tax purposes that governs income in respect of a decedent.

2. Amounts Taxable to Decedent

Assuming the decedent used the cash basis of accounting before his death, his or her final return would include only income actually or constructively received through the date of death, plus:

- a. His or her distributive share of PA S corporation income calculated by multiplying the daily amount of each class of income by the percentage of stock owned by the shareholder on each day of the corporation's taxable year that he was living;
- b. His or her distributive share of partnership income determined as of the date of death.

3. Amounts Taxable to Estate or Survivor

Any item of income or deduction that would have been reportable on the last return if the taxpayer had personally used the accrual method of accounting that is not reportable or deductible thereon using the cash basis method is taxable to, or deductible by, **neither** the decedent **nor** his estate, heirs or beneficiaries. For example, taxpayer earned a bonus as of December 31 payable on April 15, but taxpayer died on March 15. This income would not be taxable anywhere.

4. Installment Obligations Acquired from Decedent

A beneficiary that receives an unrealized installment obligation from a decedent uses the same gross profit percentage that was used by the decedent in order to arrive at the portion of each collection that represents taxable income. For example, a beneficiary may take into account business expenses incurred by the decedent before death.

F. Life Insurance Proceeds are Not Subject to Tax

The proceeds of life insurance that are received under a life insurance contract or policy and are paid by reason of the death of the insured are generally excluded from income.

III. INCOME TAX RETURN OF AN ESTATE OR TRUST

A. FILING THE INCOME TAX RETURN FOR AN ESTATE OR TRUST

An executor or administrator must file a *PA-41 Fiduciary Income Tax Return* if he or she is a fiduciary of a:

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1. Resident estate or trust that received taxable income during its taxable year.
2. Nonresident estate or trust that received taxable income allocable to Pennsylvania during its taxable year.

If the department requests, the fiduciary of an estate or trust must file a copy of the will or trust instrument (including amendments), a written declaration under the penalties of perjury that the instrument is a true and complete copy, and a statement indicating which provisions, in the fiduciary's opinion, determine the extent of taxable income to the estate or trust or the beneficiaries.

B. Mailing Instructions

If there is tax due on Line 18 of the *PA-41, Fiduciary Income Tax Return*, mail the return, check and *PA-V Payment Voucher* to:

PENNSYLVANIA DEPARTMENT OF REVENUE
BUREAU OF IMAGING AND DOCUMENT MANAGEMENT
PO BOX 280413
HARRISBURG, PA 17128-0413

If there is an Overpayment on Line 21 of the *PA-41, Fiduciary Income Tax Return*, mail the return to:

PENNSYLVANIA DEPARTMENT OF REVENUE
BUREAU OF INDIVIDUAL TAXES
PO BOX 280505
HARRISBURG, PA 17128-0505

If there is No Tax Due or Overpayment, mail the *PA-41, Fiduciary Income Tax Return* to:

PENNSYLVANIA DEPARTMENT OF REVENUE
BUREAU OF INDIVIDUAL TAXES
PO BOX 280506
HARRISBURG, PA 17128-0506

If you do not have a PA-V, make your check or money order payable to: PA Dept. of Revenue. On the check or money order:

1. Print the estate's or trust's FEIN followed by "F";
2. "2012 PA-41"; and
3. Daytime telephone number of the estate's or trust's representative.

Note. For other forms of payment and for instructions on how to complete the PA-V, go to the PA-41 instructions on the department's website.

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C. Due Date for Return

The *PA-41 Fiduciary Income Tax Return* for estates and trusts must be filed by the last date prescribed for the filing of the estate or trust's federal Form 1041 U.S. Income Tax Return for Estates and Trusts (determined without regard to extensions). The U.S. Postal Service postmark date on the envelope is proof of timely filing. A late filing of the fiduciary income tax return can result in penalty and interest fees.

D. Extension of Time to File

1. How To File

The estate or trust must submit *REV-276, Application for Extension of Time to File*, with its *PA-41, Fiduciary Income Tax Return*. Obtain *REV-276* from one of the forms ordering services and follow the instructions on the Pennsylvania extension form. An extension cannot exceed five months, unless the fiduciary is outside the U.S.

If the fiduciary expects the estate or trust to owe tax, the fiduciary must submit *REV-276, Application for Extension of Time to File*, and pay the tax due in sufficient time before the due date so that the department may consider and act upon it. The department will not send a letter granting the extension, but will write if there is a question concerning the request.

Estates and trusts may obtain an automatic five-month extension to file their federal Forms 1041. A corresponding automatic five-month extension is also allowed for filing the *PA-41, Fiduciary Income Tax Return* provided a copy of federal Form 7004, filed with the IRS, is filed with the *PA-41, Fiduciary Income Tax Return* and the federal extension is not terminated by the IRS.

Important. An extension of time to file does not extend the time to pay the fiduciary income tax due. An estate's or trust's automatic extension does not extend the beneficiary's return due date.

2. Period of Extension

The department will not grant an estate or trust an extension of time to file the *PA-41, Fiduciary Income Tax Return* for longer than five months regardless of the extension time granted for the federal return. Only taxpayers living outside the U.S. may obtain an extension period greater than five months.

3. Extension Due Date

For a calendar-year filer, the extension due date for the *PA-41, Fiduciary Income Tax Return* is September 15.

For a fiscal-year filer, the extension due date for the *PA-41, Fiduciary Income Tax Return* is five months after the original due date.

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4. Tax Due

An extension of time to file a *PA-41, Fiduciary Income Tax Return* does not extend the time for full payment of the tax, nor does it preclude the assessment of penalty and interest for underpayment of the tax due. Pay in full the amount reasonably estimated as your Pennsylvania tax due on or before the original due date.

Remittance should be made payable to the PA Dept. of Revenue and submitted with *REV-276, Application for Extension of Time to File* on or before the original due date of the *PA-41, Fiduciary Income Tax Return* for calendar year filers and the 15th day of the fourth month following the close of the fiscal year for fiscal year filers.

Print the estate's or trust's federal employer identification number on the check or money order made payable to the PA Dept. of Revenue and submit with *REV-276, Application for Extension of Time to File*.

Mail REV-276 and payment, if applicable, to:

PA DEPARTMENT OF REVENUE
BUREAU OF INDIVIDUAL TAXES
PO BOX 280504
HARRISBURG PA 17128-0504

Note. If you pay by credit card or ACH debit on or before April 15, you can get an automatic four-month extension without mailing a REV-276. On the Internet, go to www.revenue.state.pa.us and link to the E-Services Center or call, toll free, 1-888-PATAXES (1-888-728-2938).

5. Combat Zone and Hazardous Duty Service

If serving in an area so designated by the President of the U.S., Pennsylvania allows the same automatic extensions of time to file your *PA-41 Fiduciary Income Tax Return* and pay your Pennsylvania tax that the IRS provides for your federal income tax return. The automatic extension of time to file the *PA-41 Fiduciary Income Tax Return* is five months regardless of the amount of time for a federal extension. If using software or paying a preparer to file your *PA-41 Fiduciary Income Tax Return*, please print "COMBAT ZONE" at the top of your PA-41 or computer-generated PA-41 tax return. Copies of your orders and discharge papers must accompany your *PA-41 Fiduciary Income Tax Return*. If filing an electronic return through Fed/State e-file, if filing by telephone using PA TeleFile, or if filing over the Internet using padirectfile, you must fax or mail copies of your orders and discharge papers. Print "COMBAT ZONE" at the top of each page.

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6. Refund Filing Limitations

An extension granted by the department pursuant to *REV-276, Application for Extension of Time to File*, does not extend the time for filing an amended return to obtain a refund. An amended return may be filed within three years from the statutory due date (determined without regard to extension).

Also, an automatic extension of time to file the PA-41 Fiduciary Income Tax Return that is granted when an extension has been granted by the IRS for filing the federal tax return, does not extend the time for filing an amended return. An amended return must be filed within three years from the date the original return was due (determined without regard to extension) to obtain a refund.

E. Penalties for Not Filing or Late Filing

The department will assess an underpayment penalty if:

1. The estate or trust does not pay at least 90 percent of the tax due by the due date for the return; and
2. The estate or trust does not pay the remaining tax with a timely filed *PA-41 Fiduciary Income Tax Return*.

The department will charge interest on the amount not paid by the due date for the return.

If the estate or trust does not complete a timely filing of its *PA-41 Fiduciary Income Tax Return*, Pennsylvania law imposes a penalty unless the estate or trust can show reasonable cause for late filing. The penalty is five percent for each month or fraction of a month that the *PA-41, Fiduciary Income Tax Return* is late. The maximum penalty is 25 percent. The minimum penalty is five dollars. Any estate or trust that attempts to evade or defeat their Pennsylvania fiduciary income tax responsibility is subject to prosecution.

If the estate or trust does not pay its tax by the due date, Pennsylvania law imposes interest from the due date to the date of payment. The annual interest rate is the rate established by the U.S. Secretary of the Treasury that is in effect on January 1 of each calendar year.

Pennsylvania law also imposes:

1. A five percent underpayment penalty if the estate or trust does not pay the full amount of its tax due by the original due date.
2. An additional penalty of 25 percent of the tax due on the unreported income if the estate or trust does not report an amount of taxable income that is more than 25 percent of the taxable income that it reported on the *PA-41, Fiduciary Income Tax Return*.

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The department will charge these penalties if the underpayment of tax is due to negligence or intentional disregard of rules and regulations but without intent to defraud.

The department may assess both late filing and underpayment penalties if the fiduciary files the *PA-41, Fiduciary Income Tax Return* after the due date or extended due date and does not pay the tax due by the original due date.

Pennsylvania law also may impose:

1. An additional 50 percent of the tax underpayment to the total amount due if any part of the underpayment is due to fraud.
2. A \$500 penalty if the estate or trust:
 - a. Files a return that does not contain sufficient information on which to determine its correct liability; and
 - b. Files a return that contains information that indicates the liability is significantly incorrect; and
 - c. Files a return frivolously or in a manner to delay or impede the administration of the tax law.

A penalty of \$50 for each instance when any person required to furnish a *PA-41 Fiduciary Income Tax Return* either furnishes a false or fraudulent *PA-41 Schedule L* (for tax years prior to Jan. 1, 2005) and a *PA-41 Schedule RK-1 or PA-41 Schedule NRK-1* (for tax years on or after Jan. 1, 2005) to a beneficiary or fails to furnish a *PA-41 Schedule RK-1 or PA-41 Schedule NRK-1* to a beneficiary.¹

F. Separate Return for Each Estate or Trust

A trustee of two or more trusts must make a separate return for each trust even though the trusts were created by the same individual for the same beneficiaries.

G. Throwback Rules Do Not Apply

Throwback rules that apply under federal law do not apply under Pennsylvania personal income tax.

H. Calculation of Taxable Income - Overview

The taxable income of an estate or irrevocable trust is the current income that it retains for future distribution or disbursement or currently applies to discharge, satisfy, or reduce any person's or its own obligations.

¹ Beginning on or after Jan. 1, 2005, the department eliminated *PA-41 Schedule L, Beneficiaries Share of Income* and replaced it with *PA-41 Schedule RK-1, Resident Schedule of PA S Shareholder/Partner/Beneficiary Pass Through Income, Loss and Credits* and with *PA-41 Schedule NRK-1, Nonresident Schedule of PA S Shareholder/Partner/Beneficiary Pass Through Income, Loss and Credits*.

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Each estate or irrevocable trust must classify and report all income and gain (loss) realized in the appropriate Pennsylvania income classes. Estates or trusts cannot offset income in one Pennsylvania income class with a loss in any other Pennsylvania income class. Estates or trusts cannot carry income or loss back or forward to other tax years. Attach the appropriate completed schedule for the income and gain (loss) reported.

The estate or trust must also submit with its *PA-41 Fiduciary Income Tax Return* a *PA-41 Schedule RK-1* or *PA-41 Schedule NRK-1* showing all of the distributions to each of its beneficiaries.

The estate or trust must also provide each beneficiary that is an individual, estate, trust, partnership, PA S corporation or disregarded entity with a *PA-41 Schedule RK-1* or *PA-41 Schedule NRK-1* showing the beneficiary's share of Pennsylvania income that the estate or trust under its governing instrument and applicable state law distributed (or must distribute), credited, or paid to each beneficiary. Each beneficiary reports the Pennsylvania-taxable income from *PA-41 Schedule RK-1* or *PA-41 Schedule NRK-1* when filing his or her or its Pennsylvania tax return.

An estate (and its beneficiaries) and an irrevocable trust (and its beneficiaries) are not subject to tax on income that is set-aside exclusively for charitable purposes.

For fiduciary income tax purposes, no distinction is made between grantor trusts and irrevocable trusts. Each must file a *PA-41 Fiduciary Income Tax Return* and pay Pennsylvania personal income tax on any of its income or gains that it does not actually distribute to beneficiaries and which is not required to be distributed currently. So-called grantor trusts are not recognized because Pennsylvania does not have legislation similar to federal law. Conversely, for Pennsylvania personal income tax purposes, a revocable trust is not subject to tax or reporting requirements.

Pennsylvania law also differs from federal law in that trust income is reportable by beneficiaries as net income or gain derived through estates or trusts.

I. Pennsylvania Resident Estates or Trusts

Pennsylvania taxes the income of a resident estate or trust from sources both inside and outside Pennsylvania. A resident estate or trust may claim a resident credit, if it is subject to and pays income tax to another state or country on income taxable in the same taxable year to both Pennsylvania and the other state or country. This credit cannot exceed the amount of Pennsylvania tax the estate or trust owes. To claim the resident credit, the estate or trust must submit a complete *PA-40 Schedule G-L Resident Credit for Taxes Paid* or *PA-40 Schedule G-S*. The credit cannot be assigned or passed through to beneficiaries.

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J. **Nonresident Estates or Trusts or Nonresident Beneficiaries**

Pennsylvania law imposes fiduciary income tax on the income of a nonresident estate or trust from Pennsylvania sources. A nonresident estate or trust must ignore items of income, loss, cost, expense and liability that are not directly related to Pennsylvania when calculating its Pennsylvania-taxable income.

The taxable income of a nonresident beneficiary from a resident or nonresident estate or irrevocable trust is the taxable income received by the estate or trust for its taxable year that:

1. Under the governing instrument and applicable state law, the estate or trust distributed, or must distribute currently, credited, or paid to the beneficiary; and
2. Is Pennsylvania-source income.

K. **Estate or Trust is Member of PA S Corporation or Partnership**

If the estate or trust is a member of a partnership or a shareholder in a PA S corporation, it must report its share of the income (loss), whether distributed or not, in the same class in which the partnership or PA S corporation received the income. Each resident estate or trust must submit PA-41 Schedule L (for tax years prior to Jan. 1, 2005) and *PA-41 Schedule RK-1* (for tax years on or after Jan. 1, 2005) from the partnership or PA S Corporation. Each nonresident estate or trust must submit *PA-41 Schedule NRK-1* from the partnership or PA S corporation.¹

L. **Costs and Expenses**

A fiduciary may deduct only the ordinary, necessary and reasonable costs and expenses directly incurred in realizing income (loss) from:

1. The operation of a business or farm;
2. The sale, exchange or other disposition of property; and
3. The receipt of rental or royalty income.

Such expenses are deductible in determining the amount of net profits, net gains and net rental, royalty, patent and copyright income.

A fiduciary may not deduct:

1. Expenses and fees related to administering the estate or trust;

¹ Beginning on or after to Jan, 1, 2005, the department eliminated PA-41 Schedule L, Beneficiaries Share of Income and replaced it with PA-41 Schedule RK-1, Resident Schedule of PA S Shareholder/Partner/Beneficiary Pass through Income, Loss and Credits and with PA-41 Schedule NRK-1, Nonresident Schedule of PA S Shareholder/Partner/Beneficiary Pass through Income, Loss, and Credits.

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2. Costs and expenses attributable to earning or receiving interest or dividend income or managing securities holdings of the estate or trust;
3. Costs and expenses attributable to receiving income from other estates or trusts;
4. Inheritance, succession, estate or gift taxes or taxes based on income;
5. Funeral expenses;
6. Expenses for preservation or maintenance of non-income-producing property;
7. Expenses related to exempt income;
8. Satisfaction of personal debts of the decedent.

M. PA-40 Schedule DD

The IRC creates a distinction between simple trusts and complex trusts. Under the federal income tax, the income of a simple trust is taxed to its beneficiaries, whether or not distributions of current income are in fact made. This treatment is not feasible under the personal income tax because:

1. The personal income tax has no provisions comparable to IRC §§ 651 and 652;
2. A simple trust's total taxable income (line 7, *PA-41, Fiduciary Income Tax Return*) and net income (in the trust accounting sense) are seldom the same because they usually have items of gross income that are gross taxable or excludible from tax and nondeductible expenses; and
3. Simple trusts often have items of gross income that are not allocable to Pennsylvania.

As a consequence, estates, simple and complex trusts, and their beneficiaries are all taxed under the same rules.

PA-40 Schedule DD Distribution Deduction Schedule is designed to calculate how much of the income or gain received by the estate or trust is taxable to the estate or trust and how much of the income or gain is deductible because it is distributed or distributable to beneficiaries. The deduction for distributions to beneficiaries, however, is determined by reference not only to an estate or trust's distributable net income but also to its distributable net income from sources within Pennsylvania.

In determining the distribution deduction, the specific provisions of the governing instrument are controlling if it specifically provides the amounts of income (in the trust accounting sense) and source from which amounts are to be distributed, permanently set aside or used. However, usually the amounts and sources are not specified. In this

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instance, the applicable distributable net income of the estate or trust sets the limit on the deduction for distributions to beneficiaries. It also usually limits the amount of the distribution taxable to the beneficiary.

Provisions of a governing instrument that depart fundamentally from concepts of local law and primarily serve a tax avoidance purpose shall be disregarded.

PA-40 Schedule DD also is used to report how much of the taxable income or gain that would be taxable to the trust was set permanently aside for charitable purposes and is, therefore, exempt from tax.

No deduction is allowed for any amount paid or credited as a gift or bequest of specific property or of a specific sum of money if the beneficiary is not taxable on the amount under Section P – [Distributions to Beneficiaries](#).

N. Special Rules

Determine all of the following under the terms of the governing instrument and the laws applicable to the administration of estates or trusts:

1. Whether an item of receipt or expense is allocable to *corpus* or income; and
2. What part, if any, of the undistributed net income of a trust (for administrative purposes) is required to be added to *corpus*; and
3. Whether property distributed in-kind is distributed as a gift or bequest of specific property; and
4. Whether an amount is properly paid out of *corpus* as a gift or bequest of a specific amount of money; and
5. Whether payment of a distribution is directed without reference to the existence or absence of income; and
6. Whether the estate or trust must distribute an amount, and whether it pays such amount out of income or *corpus*, or it may pay such amount out of either income or *corpus*.

The specific provisions of the governing instrument are controlling when it specifically provides the source from which amounts are to be permanently set aside or used. In determining whether an amount is set aside or used for a purpose includes particular items of income received by an estate or trust in the absence of specific provisions in the governing instrument, the amount shall be deemed to consist of the same proportion of each class of the items of income of the estate or trust as the total of each class bears to the total of all classes.

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In determining whether income derived from a partnership, PA S corporation, estate or trust is required to be distributed currently or is distributed or credited to a beneficiary, the excess of the Pennsylvania-taxable income derived through such partnership, PA S corporation, estate or trust over the amount of distributions or withdrawals there from shall be considered to be income that is required to be retained, accumulated or set aside.

Amounts disbursed to pay taxes measured by the income for another taxable period may not be treated as set aside from current income.

Amounts disbursed to pay nondeductible trustee commissions, legal and accounting expenses and other current expenses that do not reduce the amount of taxable or nontaxable income or gain of the trust for the taxable year shall be treated as nontaxable income or gain for the taxable year which is required to be accumulated, retained, or set aside, if total distributions for the year do not equal or exceed the excess of total taxable and nontaxable income received by the trust for the taxable year over total taxable and nontaxable income received by the trust or estate for the taxable year which is required to be accumulated, retained, or set aside for future distribution. If total distributions for the year do equal or exceed the excess of total taxable and nontaxable income received by the trust for the taxable year over total taxable and nontaxable income received by the trust or estate for the taxable year which is required to be accumulated, retained, or set aside for future distribution, the amounts shall be treated as distributions by the trust or estate and beneficiaries.

Generally, if a resident trust consists in part of intangible investment property, such as stock or securities, or tangible investment property, such as real estate located outside Pennsylvania transferred to it by a person who at the time of the transfer was a nonresident, then the trust must make adjustments to arrive at the correct Pennsylvania-taxable income. All items of income, gain, loss or deduction in respect of such property shall be reduced in the same proportion as the trust's net Pennsylvania-taxable income bears to the trust's total taxable income.

If the income or gain is required to be distributed currently, however, there is no reduction; and if the trust is required under applicable law or its governing instrument to retain such income or gain, such items shall be wholly disregarded.

An amount properly paid or credited to the beneficiary within the first 65 days of any taxable year of an estate or trust shall be considered paid or credited to the beneficiary on the last day of the preceding taxable year if the fiduciary of the estate or trust elects to so treat such payments. The election shall be made in a statement attached to the return for the first taxable year of the trust. Any election so made shall be irrevocable for the taxable year and for all subsequent taxable years.

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O. **Income Taxable to Estate or Trust**

The income or gains of the estate or trust, if any, taxable to such estate or trust shall consist of the income or gains received by it that was not required to be distributed currently and has not been distributed or credited to its beneficiaries. See PA C.S. § 7305.

P. **Distributions to Beneficiaries**

1. **Specific Bequests of Cash or Property**

A beneficiary is not taxable on any amount paid or credited as a gift or bequest of specific property or of a specific sum of money if:

- a. The will or trust instrument provides for the gift or bequest,
- b. The money or property is ascertainable under the terms of the will as of the decedent's death or ascertainable under the terms of an irrevocable *inter vivos* trust instruction as of the date of the trust's inception, and
- c. No part of the payment or credit is paid from the current or accumulated income (in the trust accounting sense) of the trust.

None of the following constitute a specific bequest:

- a. A distribution of the income earned by a specific bequest of property or a distribution with respect to an intestate estate;
- b. Mandatory or discretionary distributions of current or accumulated income;
- c. Annuity payments; and
- d. The final required trust distribution of the remaining *corpus* as it then exists.

The income of a beneficiary of an estate or trust in respect of such estate or trust shall consist of that part of the income or gains received by the estate or trust for its taxable year ending within or with the beneficiary's taxable year which, under the governing instrument and applicable State law, is required to be distributed currently or is in fact paid or credited to said beneficiary.

This means that income received by the trust or estate on its assets which is currently distributable or, in fact, is paid or credited to a beneficiary of the trust or estate is taxable to the beneficiary. If the taxpayer is a beneficiary of one or more trusts or estates, PA-40 Schedule J must be completed to report the estate or trust income.

The beneficiary should have received a PA-41 Schedule L (for tax years prior to Jan. 1, 2005) and a PA-41 Schedule RK-1 or PA-41 Schedule NRK-1 (for tax years on or after

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Jan. 1, 2005) indicating the taxable amount of estate or trust income. If the estate or trust did not file a Pennsylvania return and did not provide and a *PA-41 Schedule RK-1* or *PA-41 Schedule NRK-1*, the taxpayer must report the amount shown on the federal Schedule K-1 adjusted to reflect Pennsylvania requirements and attach a statement explaining each adjustment.¹

If the beneficiary is a nonresident, then estate(s) or trust(s) income which is taxable to Pennsylvania includes net income (loss) from the operation of a business, profession or farm, net gain (loss) from the sale, exchange or disposition of property, and net income (loss) from rents, royalties, patents and copyrights from Pennsylvania sources. It does not include investment interest, dividends or income not from Pennsylvania sources.

Q. Filing Amended Returns

1. Amended Return or Federal Change

If after filing the *PA-41, Fiduciary Income Tax Return*, an estate or trust discovers that an incorrect return has been submitted to the department and/or federal Form 1041 has been amended or if the Internal Revenue Service changes or corrects any item of income, gain (loss) previously reported, the estate or trust must submit an amended *PA-41, Fiduciary Income Tax Return* within 30 days to the Pennsylvania Department of Revenue.

In addition, Schedule PA-41X and amended PA-41 Schedules RK-1 and/or NRK-1 must be submitted.

Important. The PA-41, Fiduciary Income Tax Return cannot be amended through Fed/State e-file.

2. Amending the PA-41, Fiduciary Income Tax Return

Beginning with tax year 2011, to amend your original *PA-41, Fiduciary Income Tax Return* use a PA-41 Fiduciary Income Tax Return and Schedule PA-41X for the tax year that is to be amended and fill in the "Amended PA-41" oval at the top of the tax return and follow these steps.

- a. Complete Schedule PA-41X.
- b. Enter the amended amounts from Schedule PA-41X per the PA-41X instructions.
- c. Calculate Line 8, Deductions from PA Schedule DD, distributed to each beneficiary and complete amended PA-41 Schedules RK-1 and NRK-1.

¹ Beginning on or after to Jan. 1, 2005, the department eliminated PA-41 Schedule L, Beneficiaries Share of Income and replaced it with PA-41 Schedule RK-1, Resident Schedule of PA S Shareholder/Partner/Beneficiary Pass through Income, Loss and Credits and with PA-41 Schedule NRK-1, Nonresident Schedule of PA S Shareholder/Partner/Beneficiary Pass through Income, Loss, and Credits.

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- d. Calculate Line 9, Net PA-Taxable Income.
- e. Calculate Line 10, Total PA Tax Liability.
- f. Calculate Line 16, 2011 Payments and Credits.
- g. Calculate Line 18, Tax Due.
- h. Complete Line 19 to report any adjusted penalty and interest to be included on the return.
- i. Do not complete Lines 20 and 21. The department's tax system is programmed to properly calculate your amended total payment or overpayment.
- j. Complete Lines 22 and 23 to notify the department how to disperse your overpayment.

The department will take the original refund or payment into account when reviewing the amended *PA-41, Fiduciary Income Tax Return*.

Be sure to sign the amended return and mail the amended return with all explanations and attachments. See Mailing Instructions.

Note. Do not send a copy of the original *PA-41, Fiduciary Income Tax Return* with the amended *PA-41, Fiduciary Income Tax Return*.

Do not file an amended *PA-41, Fiduciary Income Tax Return* after the department issues an assessment if the amendment relates to the same taxable year and assessed item of income, gain, deduction, or loss. In this instance, you either file a timely petition for reassessment or pay the assessment and file a timely petition for a refund.

R. Record Retention

All amounts reported on the *PA-41, Fiduciary Income Tax Return* and accompanying schedules are subject to verification and audit by the department. The fiduciary must retain books and records for at least seven years after filing to verify any information reported on the *PA-41, Fiduciary Income Tax Return*. If the estate or trust has an investment in a partnership or S corporation, it must retain indefinitely all tax returns and schedules RK-1 and/or NRK-1 to substantiate its basis.

S. Charitable Trusts – Special Rules

A charitable remainder or charitable income trust is not a charitable trust for Pennsylvania purposes since the earnings may inure to the benefit of a private individual. All income earned by the trust, whether or not distributed, is taxable as income from an estate or trust to the beneficiary's *PA-40, Individual Income Tax*

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Return. If it is necessary to invade the *corpus* of the trust to meet the obligation to pay the grantor, that portion of the distribution attributable to the *corpus* is not subject to tax.

IV. CONVERSION OF A RESIDENT TRUST INTO A NONRESIDENT TRUST

A resident *inter vivos* trust or a testamentary trust can become a nonresident trust if **all** of the following conditions are met:

- A. The assets of the trust currently consist in no part of:
 1. Real property or tangible personal property located within Pennsylvania;
 2. stock, securities or intangible personal property, evidenced by documents, certificates or other instruments that are physically located, or have a business *situs*, within Pennsylvania;
- B. The trust is taxable as a resident trust elsewhere for the period in question;
- C. The trust has no resident fiduciary, beneficiary, or remainderman;
- D. All administration, accounting, bookkeeping, sales, and purchases currently take place outside Pennsylvania;
- E. The settlor is no longer a resident of Pennsylvania or died a nonresident of Pennsylvania; and
- F. The settlor is not a resident at the times when, during his or her lifetime:
 1. An application is made to a court concerning the trust; or
 2. He, she, or another might have exercised a reserved power of revocation; and
 3. Both of the following apply:
 - a. A Pennsylvania court having jurisdiction over the trust has directed that the *situs* of the trust be changed to a place outside Pennsylvania, and
 - b. The courts of such place have assumed jurisdiction to:
 - Adjudicate disputes involving the trust; or
 - Order accountings to protect the trust *corpus*, beneficiaries and remaindermen.

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Pennsylvania law imposes the fiduciary income tax on the income of a nonresident estate or trust from Pennsylvania sources. A nonresident estate or trust must ignore items of income, loss, cost, expense and liability that are not directly related to Pennsylvania when computing its Pennsylvania-taxable income.

V. INCOME TAX RETURNS OF BENEFICIARIES

A. Taxation of Beneficiaries of Estates and Trusts

Income received by the estate or trust on its assets that is currently distributable or, in fact, is paid or credited to a beneficiary of the estate or trust is taxable to the beneficiary. See 72 PA C.S. § 7305. If the taxpayer is a beneficiary of one or more estates or trusts, *PA-40 Schedule J* must be completed to report the estate or trust income. The beneficiary transfers the applicable Pennsylvania-taxable income amounts to their *PA-40 Schedules J* that they submit with their *PA-40, Individual Income Tax Return*.

Each estate or taxable trust must classify and report all income, gains and losses realized in the appropriate Pennsylvania income classes.

The estate or trust must also submit PA-41 Schedules RK-1 for resident individual beneficiaries and PA-41 Schedules NRK-1 for nonresident individual beneficiaries with the estate or trust's *PA-41, Fiduciary Income Tax Return*.

If the beneficiary is an entity such as a partnership, PA S corporation, another estate or trust, the estate or trust completing the *PA-41, Fiduciary Income Tax Return*, must provide the entity with both a PA-41 Schedule RK-1 and NRK-1 showing the entity beneficiary's share of taxable income.

The PA-41 Schedules RK-1 and NRK-1 show all of the distributions to each of its beneficiaries. The estate or trust must provide each beneficiary with a personalized PA-41 Schedule RK-1 and/or NRK-1, showing that beneficiary's share of its 2012 Pennsylvania-taxable income.

A taxable trust (and its beneficiaries) and an estate (and its beneficiaries) are not subject to tax on income that is set aside exclusively for charitable purposes. See [Charitable Trust](#).

B. Basis of Property Acquired from Decedent

If property is acquired by a taxpayer by inheritance, the basis shall be the fair market value at the date of death. On subsequent disposition of the property by the beneficiary, the gain (loss) would be equal to the difference between the fair market value at the date of decedent's death and the selling price. See PA Code Section 103.13. Property passing to a decedent's estate by reason of the death of the decedent is considered to be acquired by the estate by inheritance.

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C. Charitable Trust – Special Rules

A charitable remainder or charitable income trust is not a charitable trust for Pennsylvania purposes since the earnings may inure to the benefit of a private individual. All income earned by the trust, whether or not distributed, is taxable as income from an estate or trust on the beneficiary's *PA-40, Individual Income Tax Return*. If it is necessary to invade the *corpus* of the trust to meet the obligation to pay the grantor, that portion of the distribution attributable to the *corpus* is not subject to tax.

VI. FIDUCIARY DUTIES

A. Fiduciary Must File a Return

The fiduciary of an estate or trust is required under Pennsylvania law to file a *PA-41, Fiduciary Income Tax Return*, and pay the tax on the taxable income of such estate or trust. If two or more fiduciaries are acting jointly, the return may be filed by any one of them. See 61 PA Code Section 117.5(a).

B. Fiduciary Can Be Personally Liable

The executor, administrator or trustee remains liable for tax after his or her discharge if he or she had notice of obligations or failed to exercise due diligence in ascertaining whether or not such obligations existed prior to distribution and discharge. See Pa. Stat. Ann. 72 § 7331(g); Pa. Code 61 § 117.5. **Further, 61 PA Code Section 117.5(b) provides as follows:**

Liability for the payment of tax on the taxable income of an estate attaches to the person of the executor or administrator up to and after his discharge if, prior to distribution and discharge, he had notice of his tax obligations or failed to exercise due diligence in ascertaining whether or not such obligations existed. The same considerations apply to trusts.

Upon payment of the tax, interest and penalty liability determined to be due, the fiduciary shall be discharged from personal liability except upon proof of fraud, misrepresentation or nondisclosure of a material fact. See 61 PA Code Section 119.4.

C. Liability May Follow Assets Distributed to Beneficiaries

Liability for the tax follows estate assets distributed to heirs, devisees, legatees and distributees, who may be required to discharge the amount of the tax due and unpaid to the extent of the assets distributed to them from the estate or trust. The same considerations apply to trusts. See 61 PA Code Section 117.5(b).

VII. LIQUIDATING TRUSTS

The income of a trust for the benefit of corporate shareholders established to complete the liquidation of a corporation is taxed to the taxpayer that furnished the consideration for the creation of the trust.

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VIII. NUCLEAR POWER PLANT DECOMMISSIONING TRUSTS

The income of a nuclear power plant decommissioning trust is taxed to the taxpayer that furnished the consideration for the creation of the trust.

IX. PRE-NEED FUNERAL TRUSTS OR CEMETERY MERCHANDISE TRUSTS

The income of pre-need funeral trusts or cemetery merchandise trusts (whether or not electing federally qualified funeral trust status) is taxed to the taxpayer that furnished the consideration for the creation of the trust.

Burial fund earnings are taxable income for Pennsylvania residents when the funeral home holds the account in the name of the taxpayer to pay the future funeral expenses of the taxpayer. Irrevocable burial funds are not taxable to the taxpayer. The funeral home reports the income as the custodian of the account on the *PA-41, Fiduciary Income Tax Return*. If the interest earned is income from a standard savings account it is taxable for Pennsylvania purposes.

A funeral trust is a revocable trust that arises from a contract with a person engaged in the business of providing funeral or burial services or property for these services, with the trust assets designated to pay the funeral expenses of the individual for whom the trust is established. The value of assets deposited into a funeral trust is limited to \$12,500 in Pennsylvania. The assets cannot be withdrawn for any reason until after the death of the individual for whom the trust was established. Due to the specific limitations in assets to establish withdrawals and uses, funeral trusts are not required to file the *PA-41, Fiduciary Income Tax Return*, for Pennsylvania personal income tax purposes.

X. QUALIFIED SUBCHAPTER S TRUST (QSST)

A qualified subchapter S trust (QSST) is one with respect to which an election is made and that:

- A. Owns stock in one or more electing S corporations;
- B. Distributes or is required to distribute all of its income to a citizen or resident of the U.S.;
- C. Has certain trust terms, including one requiring that there be only one income beneficiary;
- D. Does not distribute any portion of the trust *corpus* to anyone other than the current income beneficiary during the income beneficiary's lifetime, including the time at which the trust terminates; and
- E. Has the income interest of the current income beneficiary cease on the earlier of such beneficiary's death or the termination of the trust.

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This trust is eligible to become a shareholder of an S corporation if the current individual income beneficiary of the trust elects to be treated as the owner of the trust for purposes of the Internal Revenue Code.

For federal income tax purposes, the QSST beneficiary is taxed on all items of income, deduction, loss or credit of the QSST.

To qualify as a QSST, the trust instrument must require that:

- A. During the life of the current income beneficiary, there shall be only one current income beneficiary of the trust;
- B. Any *corpus* distributed during the life of the current income beneficiary shall be distributed only to such beneficiary;
- C. The beneficial interest of the current income beneficiary must terminate upon the earlier of that beneficiary's death or the trust termination;
- D. Upon the trust's termination during the life of the current income beneficiary, the trust must distribute all of its assets to such beneficiary; and
- E. All *trust income* must be distributed currently (at least annually) to only one individual who is a citizen or resident of the U.S. (successive income beneficiaries are permitted, however).

For Pennsylvania personal income tax purposes, the S corporation income will flow through the trust to the income beneficiary. The income shall be reported to the income beneficiary in the same manner as it was reported by the S corporation to the trust. All income shall retain its original classification.