

Publication 559

Survivors, Executors, and Administrators

For use in preparing

2024 Returns

Volume 2 of 4



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If the decedent is a specified terrorist victim (see Specified Terrorist Victim, earlier), income received after the date of death and before the end of the decedent's tax year (determined without regard to death) is excluded from the recipient's gross income. This exclusion doesn't apply to certain income. For more information, see Pub. 3920.

How To Report

Income in respect of a decedent must be included in the income of one of the following.

- The decedent's estate, if the estate receives it.
- The beneficiary, if the right to income is passed directly to the beneficiary and the beneficiary receives it.
- Any person to whom the estate properly distributes the right to receive it.



If you have to include income in respect of a decedent in your gross income and an estate tax return (Form 706) was filed for the decedent, you may be able to claim a deduction for the estate tax paid on that income. See Estate Tax Deduction, later.

Example 1. F. Johnson owned and operated an apple orchard and used the cash method of accounting. F. Johnson sold and delivered 1,000 bushels of apples to a canning factory for \$2,000, but didn't receive payment before death. The proceeds from the sale are income in respect of a decedent. When the estate was settled, payment had not been made and the estate transferred the right to the payment to F. Johnson's surviving spouse. When the surviving spouse collects the \$2,000, that amount must be included in the surviving spouse's return. It isn't reported on the final return of the decedent or on the return of the estate.

Example 2. Assume the same facts as in *Example 1*, except that F. Johnson used the accrual method of accounting. The amount accrued from the sale of the apples would be included on F. Johnson's final return. Neither the estate nor the surviving spouse would realize income in respect of a decedent when the money is later paid.

Example 3. On February 1, G. High, a cash method taxpayer sold a tractor for \$3,000, payable March 1 of the same year. G. High's adjusted basis in the tractor was \$2,000. G. High died on February 15, before receiving payment. The gain to be reported as income in respect of a decedent is the \$1,000 difference between the decedent's basis in the property and the sale proceeds. In other words, the income in respect of a decedent is the gain the decedent would have realized had the decedent lived.

Example 4. C. O'Neil was entitled to a large salary payment at the date of death. The amount was to be paid in five annual installments. The estate, after collecting two installments, distributed the right to the remaining installments to you, the beneficiary. The payments are income in respect of a decedent. None of the payments were includible on C. O'Neil's final return. The estate must include in its income the two installments it received, and you must include in your income each of the three installments as you receive them.

Example 5. Danny inherited the right to receive renewal commissions on life insurance sold by Danny's parent, Taylor, before Taylor's death. Danny inherited the right from Danny's other parent, Charlie, who acquired it by bequest from Taylor. Charlie died before receiving all the commissions Charlie had the right to receive, so Danny received the rest.

The commissions are income in respect of a decedent. None of these commissions were includible in Taylor's final return. The commissions received by Charlie were included in Charlie's income. The commissions Danny received aren't includible in Charlie's income, even on Charlie's final return. Danny must include them in Danny's income.

Character of income. The character of the income you receive in respect of a decedent remains the same as it would have been to the decedent if the decedent were alive. If the income would have been a capital gain to the decedent, it will be a capital gain to you.

Transfer of right to income. If you transfer your right to income in respect of a decedent, you must include in your income the greater of:

- The amount you receive for the right, or
- The FMV of the right you transfer.

If you make a gift of such a right, you must include in your income the FMV of the right at the time of the gift.

If the right to income from an installment obligation is transferred, the amount you must include in income is reduced by the basis of the obligation. See *Installment obligations*, later.

Transfer defined. A transfer for this purpose includes a sale, exchange, or other disposition, the satisfaction of an installment obligation at other than face value, or the cancellation of an installment obligation.

Installment obligations. If the decedent sold property using the installment method and you are collecting payments on an installment obligation acquired from the decedent, use the same gross profit percentage the decedent used to figure the part of each payment that represents profit.

Include in your income the same profit the decedent would have included had death not occurred. For more information, see Pub. 537, Installment Sales.

If you dispose of an installment obligation acquired from a decedent (other than by transfer to the obligor), the rules explained in Pub. 537 for figuring gain or loss on the disposition apply to you.

Transfer to obligor. A transfer of a right to income, discussed earlier, has occurred if the decedent (seller) sold property using the installment method and the installment obligation was transferred to the obligor (buyer or person legally obligated to pay the installments). A transfer also occurs if the obligation was canceled either at death or by the estate or person receiving the obligation from the decedent. An obligation that becomes unenforceable is treated as having been canceled.

If such a transfer occurs, the amount included in the income of the transferor (the estate or beneficiary) is the greater of the amount received or the FMV of the installment obligation at the time of transfer, reduced by the basis of the obligation. The basis of the obligation is the decedent's basis, adjusted for all installment payments received after the decedent's death and before the transfer.

If the decedent and obligor were related persons, the FMV of the obligation can't be less than its face value.

Specific Types of Income in Respect of a Decedent

This section explains and provides examples of some specific types of income in respect of a decedent.

Wages. The entire amount of wages or other employee compensation earned by the decedent but unpaid at the time of death is income in respect of a decedent.

The income isn't reduced by any amounts withheld by the employer. If the income is \$600 or more, the employer should report it in box 3 of Form 1099-MISC, Miscellaneous Income, and give the recipient a copy of the form or a similar statement.

Wages paid as income in respect of a decedent aren't subject to federal income tax withholding. However, if paid during the calendar year of death, they are subject to withholding for social security and Medicare taxes. These taxes should be included on the decedent's Form W-2 along with the taxes withheld before death. These wages aren't included in box 1 of Form W-2.

Wages paid as income in respect of a decedent after the year of death aren't generally subject to withholding for any federal taxes.

Farm income from crops, crop shares, and livestock. A farmer's growing crops and livestock at the date of death wouldn't

normally give rise to income in respect of a decedent or income to be included in the final return. However, when a cash method farmer receives rent in the form of crop shares or livestock and owns the crop shares or livestock at the time of death, the rent is income in respect of a decedent and is reported in the year in which the crop shares or livestock are sold or otherwise disposed of. The same treatment applies to crop shares or livestock that the decedent had a right to receive as rent at the time of death for economic activities that occurred before death.

If the individual died during a rental period, only the net proceeds from the part of the rental period ending on the date of death are income in respect of a decedent. The proceeds from the rental period from the day after death to the end of the rental period are ordinary income to the estate.

Cash rent or crop shares and livestock received as rent and reduced to cash by the decedent are includible on the final return even though the rental period didn't end until after death.

Example. A. Roberts, who used the cash method of accounting, leased part of the farm for a 1-year period beginning March 1. The rental was one-third of the crop, payable in cash when the crop share is sold at the direction of A. Roberts. A. Roberts died on June 30 and was alive during 122 days of the rental period. Seven months later, A. Roberts' personal representative ordered the crop to be sold and was paid \$1,500. Of the \$1,500, $122/365$, or \$501, is income in respect of a decedent. The balance of the \$1,500 received by the estate, \$999, is income to the estate.

Partnership income. If the decedent had been receiving payments representing a distributive share or guaranteed payment in liquidation of the decedent's interest in a

partnership, the remaining payments made to the estate or other successor in interest are income in respect of a decedent. The estate or the successor receiving the payments must include them in income when received.

Similarly, the estate or other successor in interest receives income in respect of a decedent if amounts are paid by a third person in exchange for the successor's right to the future payments.

For a discussion of partnership rules, see Pub. 541, Partnerships.

U.S. savings bonds acquired from decedent. If series EE or series I U.S. savings bonds, owned by a cash method taxpayer who reported the interest each year, or by an accrual method taxpayer, are transferred because of death, the increase in value of the bonds (interest earned) in the year of death up to the date of death must be reported on the decedent's final return.

The transferee (estate or beneficiary) reports on its return only the interest earned after the date of death.

The redemption values of U.S. savings bonds are generally available from local banks, credit unions, savings and loan institutions, or your nearest Federal Reserve Bank.

You can also get information by writing to the following address.



Series EE and Series I
Treasury Retail Securities Services
P.O. Box 9150
Minneapolis, MN 55480-9150



Or go to [TreasuryDirect.gov](https://www.treasurydirect.gov).

If the bonds transferred because of death were owned by a cash method taxpayer who chose not to report the interest each year and had purchased the bonds entirely with personal funds,

interest earned before death must be reported in one of the following ways.

1. The person (executor, administrator, etc.) who is required to file the decedent's final income tax return can elect to include all of the interest earned on the bonds before the decedent's death on the return. The transferee (estate or beneficiary) then includes only the interest earned after the date of death on its return.
2. If the election in (1) above wasn't made, the interest earned to the date of death is income in respect of the decedent and isn't included on the decedent's final return. In this case, all of the interest earned before and after the decedent's death is income to the transferee (estate or beneficiary). A transferee who uses the cash method of accounting and who has chosen not to report the interest annually may

defer reporting any of it as income until the bonds are either cashed or reach the date of maturity, whichever is earlier. In the year the interest is reported, the transferee may claim a deduction for any federal estate tax paid that arose because of the part of interest (if any) included in the decedent's estate.

Example 1. Your relative, Drew, a cash method taxpayer, died and left you a \$1,000 series EE bond. Drew bought the bond for \$500 and had not chosen to report the increase in value each year. At the date of death, interest of \$94 had accrued on the bond, and its value of \$594 at date of death was included in Drew's estate. Drew's personal representative didn't choose to include the \$94 accrued interest on the decedent's final income tax return. You are a cash method taxpayer and don't choose to report the increase in value each year as it is

earned. Assuming you cash it when it reaches maturity value of \$1,000, you would report \$500 interest income (the difference between maturity value of \$1,000 and the original cost of \$500) in that year. You are also entitled to claim, in that year, a deduction for any federal estate tax resulting from the inclusion in Drew's estate of the \$94 increase in value.

Example 2. If, in *Example 1*, the personal representative had chosen to include the \$94 interest earned on the bond before death in the final income tax return for Drew, you would report \$406 ($\$500 - \94) as interest when you cashed the bond at maturity. This \$406 represents the interest earned after Drew's death and wasn't included in Drew's estate, so no deduction for federal estate tax is allowable for this amount.

Example 3. Drew died owning series HH bonds Drew acquired in exchange for series EE bonds. You were the beneficiary of these bonds.

Drew used the cash method of accounting and had not chosen to report the increase in redemption price of the series EE bonds each year as it accrued. Drew's personal representative made no election to include any interest earned before death on the decedent's final return. Your income in respect of the decedent is the sum of the unreported increase in value of the series EE bonds, which constituted part of the amount paid for the series HH bonds, and the interest, if any, payable on the series HH bonds but not received as of the date of the decedent's death.

Specific dollar amount legacy satisfied by transfer of bonds. If a beneficiary receives series EE or series I bonds from an estate in satisfaction of a specific dollar amount legacy and the decedent was a cash method taxpayer who didn't elect to report interest each year, only the interest earned after receipt of the bonds is income to the

beneficiary. The interest earned to the date of death plus any further interest earned to the date of distribution is income to (and reportable by) the estate.

Cashing U.S. savings bonds. When you cash a U.S. savings bond that you acquired from a decedent, the bank or other payer that redeems it must give you a Form 1099-INT if the interest part of the payment you receive is \$10 or more. Your Form 1099-INT should show the difference between the amount received and the cost of the bond. The interest shown on your Form 1099-INT won't be reduced by any interest reported by the decedent before death, or, if elected, by the personal representative on the final income tax return of the decedent, or by the estate on the estate's income tax return. Your Form 1099-INT may show more interest than you must include in your income.

You must make an adjustment on your tax return to report the correct amount of interest. Report the total interest shown on Form 1099-INT on your Schedule B (Form 1040). Enter a subtotal of the interest shown on Forms 1099, and the interest reportable from other sources for which you didn't receive Forms 1099. Show the total interest that was previously reported and subtract it from the subtotal. Identify this adjustment as "U.S. Savings Bond Interest Previously Reported."

Interest accrued on U.S. Treasury bonds.

The interest accrued on U.S. Treasury bonds owned by a cash method taxpayer and redeemable for the payment of federal estate taxes that wasn't received as of the date of the individual's death is income in respect of a decedent. This interest isn't included in the decedent's final income tax return.

The estate will treat such interest as taxable income in the tax year received if it chooses to redeem the U.S. Treasury bonds to pay federal estate taxes. If the person entitled to the bonds (by bequest, devise, or inheritance, or because of the death of the individual) receives them, that person will treat the accrued interest as taxable income in the year the interest is received. Interest that accrues on the U.S. Treasury bonds after the owner's death doesn't represent income in respect of a decedent. The interest, however, is taxable income and must be included in the income of the respective recipients.

Interest accrued on savings certificates.

The interest accrued on savings certificates (redeemable after death without forfeiture of interest) for the period from the date of the last interest payment and ending with the date of the decedent's death, but not received as of that date, is income in respect of a decedent.

Interest accrued after the decedent's death that becomes payable on the certificates after death isn't income in respect of a decedent, but is taxable income includible in the income of the respective recipients.

Inherited individual retirement arrangements (IRAs). If a beneficiary receives a lump-sum distribution from a traditional IRA the beneficiary inherited, all or some of it may be taxable. The distribution is taxable in the year received as income in respect of a decedent up to the decedent's taxable balance. This is the decedent's balance at the time of death, including unrealized appreciation and income accrued to date of death, minus any basis (nondeductible contributions). Amounts distributed that are more than the decedent's entire IRA balance (includes taxable and nontaxable amounts) at the time of death are the income of the beneficiary.

If the beneficiary of a traditional IRA is the decedent's surviving spouse who properly rolls over the distribution into another traditional IRA, the distribution isn't currently taxed. A surviving spouse can also roll over tax free the taxable part of the distribution into a qualified plan, section 403 annuity, or section 457 plan.

For more information on inherited IRAs, see Pub. 590-B, Distributions from Individual Retirement Arrangements (IRAs).

Roth IRAs. Qualified distributions from a Roth IRA aren't subject to tax. A distribution made to a beneficiary or to the Roth IRA owner's estate on or after the date of death is a qualified distribution if it is made after the 5-tax-year period beginning with the first tax year in which a contribution was made to any Roth IRA of the owner.

Generally, the entire interest in the Roth IRA must be distributed by the end of the fifth calendar year after the year of the owner's

death unless the interest is payable to a designated beneficiary over the beneficiary's life or life expectancy. If paid as an annuity, the distributions must begin before the end of the calendar year following the year of death. If the sole beneficiary is the decedent's spouse, the spouse can delay the distributions until the decedent would have reached the applicable age or can treat the Roth IRA as the spouse's own Roth IRA.

The part of any distribution made to a beneficiary that isn't a qualified distribution may be includible in the beneficiary's income. Generally, the part includible is the earnings in the Roth IRA. Earnings attributable to the period ending with the decedent's date of death are income in respect of a decedent. Additional earnings are the income of the beneficiary.

For more information on Roth IRAs, see Pub. 590-A, Contributions to Individual Retirement Arrangements (IRAs), and Pub. 590-B.

Coverdell ESA. Generally, the balance in a Coverdell ESA must be distributed within 30 days after the individual for whom the account was established reaches age 30 or dies, whichever is earlier. The treatment of the Coverdell ESA at the death of an individual under age 30 depends on who acquires the interest in the account. If the decedent's estate acquires the interest, see the discussion under *Final Income Tax Return for Decedent—Form 1040 or 1040-SR*, earlier.



The age 30 limitation doesn't apply if the individual for whom the account was established or the beneficiary that acquires the account is an individual with special needs. This includes an individual who, because of a physical, mental, or emotional condition (including a learning disability), requires additional time to complete the individual's education.

If the decedent's spouse or other family member is the designated beneficiary of the decedent's account, the Coverdell ESA becomes that person's Coverdell ESA. It is subject to the rules discussed in Pub. 970.

Any other beneficiary (including a spouse or family member who isn't the designated beneficiary) must include in income the earnings portion of the distribution. Any balance remaining at the close of the 30-day period is deemed to be distributed at that time. The amount included in income is reduced by any qualified education expenses of the decedent that are paid by the beneficiary within 1 year after the decedent's date of death. An estate tax deduction, discussed later, applies to the amount included in income by a beneficiary other than the decedent's spouse or family member.

HSA, Archer MSA, or Medicare Advantage MSA. The treatment of an HSA, an Archer MSA, or a Medicare Advantage MSA at the

death of the account holder depends on who acquires the interest in the account. If the decedent's estate acquired the interest, see the discussion under *Final Income Tax Return for Decedent—Form 1040 or 1040-SR*, earlier.

If the decedent's spouse is the designated beneficiary of the account, the account becomes that spouse's Archer MSA. It is subject to the rules discussed in Pub. 969.

Any other beneficiary (including a spouse that isn't the designated beneficiary) must include in income the FMV of the assets in the account on the decedent's date of death. This amount must be reported for the beneficiary's tax year that includes the decedent's date of death. The amount included in income is reduced by any qualified medical expenses for the decedent paid by the beneficiary within 1 year after the decedent's date of death. An estate tax deduction, discussed later, applies to the amount included in income by a beneficiary other than the decedent's spouse.

Deductions in Respect of a Decedent

Items such as business expenses, income-producing expenses, interest, and taxes, for which the decedent was liable but that aren't properly allowable as deductions on the decedent's final income tax return will be allowed as a deduction to one of the following when paid.

- The estate.
- The person who acquired an interest in the decedent's property (subject to such obligations) because of the decedent's death, if the estate wasn't liable for the obligation.

Note. Similar treatment is given to the foreign tax credit. A beneficiary who must pay a foreign tax on income in respect of a decedent will be entitled to claim the foreign tax credit.

Depletion. The deduction for percentage depletion is allowable only to the person (estate or beneficiary) who receives income in respect of a decedent to which the deduction relates, whether or not that person receives the property from which the income is derived. An heir who (because of the decedent's death) receives income as a result of the sale of units of mineral by the decedent (who used the cash method) will be entitled to the depletion allowance for that income. If the decedent had not figured the deduction on the basis of percentage depletion, any depletion deduction to which the decedent was entitled at the time of death is allowable on the decedent's final return, and no depletion deduction in respect of a decedent is allowed to anyone else.

For more information about depletion, see chapter 9 in Pub. 535, Business Expenses.

Estate Tax Deduction

Income that the decedent had a right to receive is included in the decedent's gross estate and is subject to estate tax. This income in respect of a decedent is also taxed when received by the recipient (estate or beneficiary). However, an income tax deduction is allowed to the recipient for the estate tax paid on the income.

The deduction for estate tax paid can only be claimed for the same tax year in which the income in respect of a decedent must be included in the recipient's income.

(This is also true for income in respect of a prior decedent.)

Individuals can claim this deduction only as an itemized deduction on line 16 of Schedule A (Form 1040). Estates can claim the deduction on line 19 of Form 1041.

If income in respect of a decedent is capital gain income, you must reduce the gain, but not below zero, by any deduction for estate tax paid on such gain. This applies in figuring the following.

- The maximum tax on net capital gain (including qualified dividends).
- The exclusion for gain on small business stock under section 1202.
- The limitation on capital losses.

Computation

To figure a recipient's estate tax deduction, determine:

- The estate tax that qualifies for the deduction, and
- The recipient's part of the deductible tax.

Deductible estate tax. The estate tax is the tax on the taxable estate, reduced by any credits allowed.

The estate tax qualifying for the deduction is the part of the net value of all the items in the estate that represent income in respect of a decedent. Net value is the excess of the items of income in respect of a decedent over the items of expenses in respect of a decedent. The deductible estate tax is the difference between the actual estate tax and the estate tax determined without including net value.

Example 1. J. Sage used the cash method of accounting. At the time of death, J. Sage was entitled to receive \$12,000 from clients for services provided and had accrued bond interest of \$8,000, for total income in respect of a decedent of \$20,000. J. Sage also owed \$5,000 for business expenses for which the estate is liable. The income and expenses are reported on J. Sage's estate tax return.

The tax on J. Sage's estate is \$9,460, after credits. The net value of the items included as income in respect of the decedent is \$15,000

(\$20,000 – \$5,000). The estate tax determined without including the \$15,000 in the taxable estate is \$4,840, after credits. The estate tax that qualifies for the deduction is \$4,620 (\$9,460 – \$4,840).

Recipient's deductible part. Figure the recipient's part of the deductible estate tax by dividing the estate tax value of the items of income in respect of a decedent included in the recipient's income (the numerator) by the total value of all items included in the estate that represent income in respect of a decedent (the denominator). If the amount included in the recipient's income is less than the estate tax value of the item, use the lesser amount in the numerator.

Example 2. As the beneficiary of J. Sage's estate (*Example 1*), you collect the \$12,000 accounts receivable from J. Sage's clients. You will include the \$12,000 in your income in the tax year you receive it.

If you itemize your deductions in that tax year, you can claim an estate tax deduction of \$2,772 figured as follows:

Value included in your income				
<hr/>				
Total value of income in respect of decedent	X	Estate tax qualifying for deduction		
 \$12,000				
<hr/>	X	\$4,620	=	\$2,772
\$20,000				

If the amount you collected for the accounts receivable was more than \$12,000, you would still claim \$2,772 as an estate tax deduction because only the \$12,000 actually reported on the estate tax return can be used in the above computation.

However, if you collected less than the \$12,000 reported on the estate tax return, use the smaller amount to figure the estate tax deduction.

Estates. The estate tax deduction allowed to an estate is figured in the same manner discussed earlier. However, any income in respect of a decedent received by the estate during the tax year is reduced by any such income properly paid, credited, or required to be distributed by the estate to a beneficiary. The beneficiary would include such distributed income in respect of a decedent for figuring the beneficiary's estate tax deduction.

Surviving annuitants. For the estate tax deduction, an annuity received by a surviving annuitant under a joint and survivor annuity contract is considered income in respect of a decedent. The deceased annuitant must have died after the annuity starting date.

You must make a special computation to figure the estate tax deduction for the surviving annuitant. See Regulations section 1.691(d)-1.

Gifts, Insurance, and Inheritances

Property received as a gift, bequest, or inheritance isn't included in your income. However, if property you receive in this manner later produces income, such as interest, dividends, or rents, that income is taxable to you. The income from property donated to a trust that is paid, credited, or distributed to you is taxable income to you. If the gift, bequest, or inheritance is the income from property, that income is taxable to you.

If you receive property from a decedent's estate in satisfaction of your right to the income of the estate, it is treated as a bequest or inheritance of income from property. See *Distributions to Beneficiaries*, later.

Insurance

The proceeds from a decedent's life insurance policy paid by reason of the decedent's death are generally excluded from income. The exclusion applies to any beneficiary, whether a family member or other individual, a corporation, or a partnership.

Veterans' insurance proceeds.

Veterans' insurance proceeds and dividends aren't taxable either to the veteran or to the beneficiaries.

Interest on dividends left on deposit with the Department of Veterans Affairs isn't taxable.

Life insurance proceeds. Life insurance proceeds paid to a beneficiary because of the death of the insured (or because the insured is a member of the U.S. uniformed services who is missing in action) aren't taxable unless the policy was turned over to the recipient for a price.

This is true even if the proceeds are paid under an accident or health insurance policy or an endowment contract. If the proceeds are received in installments, see the discussion under *Insurance received in installments*, later.

Accelerated death benefits. A beneficiary can exclude from income accelerated death benefits received on the life of an insured individual if certain requirements are met. Accelerated death benefits are amounts received under a life insurance contract before the death of the insured. These benefits also include amounts received on the sale or assignment of the contract to a viatical settlement provider. This exclusion applies only if the insured was a terminally ill individual or a chronically ill individual. This exclusion doesn't apply if the insured is a director, officer, or employee, or has a financial interest in any trade or business carried on by the beneficiary.

Terminally ill individual. A *terminally ill individual* is one who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death in 24 months or less from the date of certification.

Chronically ill individual. A *chronically ill individual* is one who has been certified as one of the following.

- An individual who, for at least 90 days, is unable to perform at least two activities of daily living without substantial assistance due to a loss of functional capacity.
- An individual who requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

A certification must have been made by a licensed health care practitioner within the previous 12 months.

Exclusion limited. If the insured was a chronically ill individual, exclusion of accelerated death benefits is limited to the cost incurred in providing qualified long-term care services for the insured. In determining the cost incurred, don't include amounts paid or reimbursed by insurance or otherwise. Subject to certain limits, exclude payments received on a periodic basis without regard to costs.

Interest option on insurance. If an insurance company pays interest only on proceeds from life insurance left on deposit, the interest is taxable.

Insurance received in installments. If a beneficiary receives life insurance proceeds in installments, the beneficiary can exclude part of each installment from income.

To determine the part excluded, divide the amount held by the insurance company (generally the total lump sum payable at the

death of the insured person) by the number of installments to be paid. Include anything over this excluded part in income as interest.

Specified number of installments. If a beneficiary will receive a specified number of installments under the insurance contract, figure the part of each installment the beneficiary can exclude by dividing the amount held by the insurance company by the number of installments to which the beneficiary is entitled. In case the beneficiary dies before receiving all the installments, a secondary beneficiary is entitled to the same exclusion.

Example. As beneficiary, you choose to receive \$100,000 of life insurance proceeds in 10 annual installments of \$11,000. Each year, you can exclude from your income \$10,000 ($\$100,000 \div 10$) as a return of principal. The balance of the installment, \$1,000, is taxable as interest income.

Specified amount payable. If each installment received under the insurance contract is a specific amount based on a guaranteed rate of interest, but the number of installments that will be received is uncertain, the part of each installment excluded from income is the amount held by the insurance company divided by the number of installments necessary to use up the principal and guaranteed interest in the contract.

Example. The face amount of the policy is \$200,000, and, as beneficiary, you choose to receive annual installments of \$12,000. The insurer's settlement option guarantees you this amount for 20 years based on a guaranteed rate of interest. It also provides that extra interest may be credited to the principal balance according to the insurer's earnings. The excludable part of each guaranteed installment is \$10,000 ($\$200,000 \div 20$ years).

The balance of each guaranteed installment, \$2,000, is interest income to you. The full amount of any additional payment for interest is income to you.

Installments for life. If the beneficiary under an insurance contract is entitled to receive the proceeds in installments for the rest of the beneficiary's life without a refund or period-certain guarantee, the excluded part of each installment can be determined by dividing the amount held by the insurance company by the beneficiary's life expectancy. If there is a refund or period-certain guarantee, the amount held by the insurance company for this purpose is reduced by the actuarial value of the guarantee.

Example. As beneficiary, you choose to receive the \$50,000 proceeds from a life insurance contract under a life-income-with-cash-refund option. You are guaranteed \$2,700 a year for the rest of your life (which is estimated by use of mortality tables to be

25 years from the insured's death). The actuarial value of the refund feature is \$9,000. The amount held by the insurance company, reduced by the value of the guarantee, is \$41,000 ($\$50,000 - \$9,000$) and the excludable part of each installment representing a return of principal is \$1,640 ($\$41,000 \div 25$). The remaining \$1,060 ($\$2,700 - \$1,640$) is interest income to you. If you should die before receiving the entire \$50,000, the refund payable to the refund beneficiary isn't taxable.

Flexible premium contracts. A life insurance contract (including any qualified additional benefits) qualifies as a flexible premium life insurance contract if it provides for the payment of one or more premiums that aren't fixed by the insurer as to both timing and amount. For a flexible premium contract issued before January 1, 1985,

the proceeds paid under the contract because of the death of the insured will be excluded from the recipient's income only if the contract meets the requirements explained under section 101(f).

Basis of Inherited Property

The basis of property inherited from a decedent is generally one of the following.

- The FMV of the property on the date of the individual's death.
- The FMV on the alternate valuation date (discussed in the Instructions for Form 706) if elected by the personal representative.
- The value under the special-use valuation method for real property used in farming or other closely held business (see *Special-use valuation*, later), if elected by the personal representative.

- The decedent's adjusted basis in land to the extent of the value excluded from the decedent's taxable estate as a qualified conservation easement (discussed in the Instructions for Form 706).

Exception for appreciated property. If you or your spouse gave appreciated property to an individual during the 1-year period ending on the date of that individual's death and you (or your spouse) later acquired the same property from the decedent, your basis in the property is the same as the decedent's adjusted basis immediately before death.

Appreciated property. Appreciated property is property that had an FMV greater than its adjusted basis on the day it was transferred to the decedent.

Special-use valuation. If you are a qualified heir and you receive a farm or other closely held business real property from the estate for which the personal representative elected special-use valuation,

the property is valued on the basis of its actual use rather than its FMV.

If you are a qualified heir and you buy special-use valuation property from the estate, your basis is equal to the estate's basis (determined under the special-use valuation method) immediately before your purchase plus any gain recognized by the estate.

You are a qualified heir if you are an ancestor (parent, grandparent, etc.), the spouse, or a lineal descendant (child, grandchild, etc.) of the decedent, a lineal descendant of the decedent's parent or spouse, or the spouse of any of these lineal descendants.

For more information on special-use valuation, see the Instructions for Form 706.

Increased basis for special-use valuation property. Under certain conditions, some or all of the estate tax benefits obtained by using the special-use valuation will be subject

to recapture. Generally, an additional estate tax must be paid by the qualified heir if the property is disposed of, or is no longer used for a qualifying purpose within 10 years of the decedent's death.

If you must pay any additional estate (recapture) tax, you can elect to increase your basis in the special-use valuation property to its FMV on the date of the decedent's death (or on the alternate valuation date, if it was elected by the personal representative). If you elect to increase your basis, you must pay interest on the recapture tax for the period beginning 9 months after the decedent's death until the date you pay the recapture tax.

For more information on the recapture tax, see the Instructions for Form 706-A, United States Additional Estate Tax Return.

S corporation stock. The basis of inherited S corporation stock must be reduced if there is income in respect of a decedent attributable to that stock.

Joint interest. Figure the surviving tenant's new basis of jointly owned property (joint tenancy or tenancy by the entirety) by adding the surviving tenant's original basis in the property to the value of the part of the property included in the decedent's estate, discussed earlier. Subtract from the sum any deductions for wear and tear, such as depreciation or depletion, allowed to the surviving tenant on that property.

Example. F. Maple and sibling, A. Maple, owned, as joint tenants with right of survivorship, rental property they purchased for \$60,000. A. Maple paid \$15,000 of the purchase price and F. Maple paid \$45,000. Under local law, each had a half interest in the income from the property.

When F. Maple died, the FMV of the property was \$100,000. Depreciation deductions allowed before F. Maple's death were \$20,000. A. Maple's basis in the property is \$80,000, figured as follows:

A. Maple's original basis	\$15,000	
Interest acquired from F. Maple(3/4 of \$100,000)	<u>75,000</u>	\$90,000
Minus: 1/2 of \$20,000 depreciation		<u>10,000</u>
A. Maple's basis.....		<u>\$80,000</u>

Qualified joint interest. One-half of the value of property owned by a decedent and spouse as tenants by the entirety, or as joint tenants with right of survivorship if the decedent and spouse are the only joint tenants, is included in the decedent's gross estate. This is true regardless of how much each contributed toward the purchase price.

Figure the basis for a surviving spouse by adding one-half of the property's cost basis to the value included in the gross estate. Subtract from this sum any deductions for wear and tear, such as depreciation or depletion, allowed on that property to the surviving spouse.

Example. D. Gilbert and J. Gilbert owned, as tenants by the entirety, rental property they purchased for \$60,000. D. Gilbert paid \$15,000 of the purchase price and J. Gilbert paid \$45,000. Under local law, each had a half interest in the income from the property. When J. Gilbert died, the FMV of the property was \$100,000. Depreciation deductions allowed before J. Gilbert's death were \$20,000. D. Gilbert's basis in the property is \$70,000, figured as follows:

One-half of cost basis (1/2 of \$60,000)...	\$30,000	
Interest acquired from J. Gilbert(1/2 of \$100,000).....	<u>50,000</u>	\$80,000
Minus: 1/2 of \$20,000 depreciation.....		<u>10,000</u>
D. Gilbert's basis.....		<u>\$70,000</u>

See Pub. 551, Basis of Assets, for more information on basis. If the decedent and their spouse lived in a community property state, see the discussion in that publication about figuring the basis of community property after a spouse's death.

Depreciation. If a beneficiary can depreciate inherited property, the Modified Accelerated Cost Recovery System (MACRS) must be used to determine depreciation.

For joint interests and qualified joint interests, use the following computations to figure depreciation.

- The first computation is for the original basis in the property.
- The second computation is for the inherited part of the property.

Continue depreciating the original basis under the same method used in previous years.

Depreciate the inherited part using MACRS.

MACRS consists of two depreciation systems, the General Depreciation System (GDS) and the Alternative Depreciation System (ADS).

For more information on MACRS, see Pub. 946, How To Depreciate Property.

Valuation misstatements. If the value or adjusted basis of any property claimed on an income tax return is 150% or more of the amount determined to be the correct amount, there is a substantial valuation misstatement.

If the value or adjusted basis is 200% or more of the amount determined to be the correct amount, there is a gross valuation misstatement.

Understatements. A substantial estate or gift tax valuation misstatement occurs when the value of property reported is 65% or less of the actual value of the property. A gross valuation misstatement occurs if any property on a return is valued at 40% or less of the value determined to be correct.

Penalty. If a misstatement results in an underpayment of tax of more than \$5,000, an addition to tax of 20% of the underpayment can apply. The penalty increases to 40% if the value or adjusted basis reported is a gross valuation misstatement.

The IRS may waive all or part of the 20% addition to tax (for substantial valuation overstatement) if the following apply.

- The claimed value of the property was based on a qualified appraisal made by a qualified appraiser.
- In addition to obtaining such appraisal, the taxpayer made a good faith investigation of the value of the contributed property.

No waiver is available for the 40% addition to tax (for gross valuation overstatement).

For transitional guidance on the definitions of “qualified appraisal” and “qualified appraiser,” see Notice 2006-96, 2006-46 I.R.B. 902, available at IRS.gov/irb/2006-46_IRB/ar13.html.

The definitions apply to appraisals prepared for the following.

- Donated property for which a deduction of more than \$5,000 is claimed.
- Returns filed after August 17, 2006.

Holding period. If you sell or dispose of inherited property that is a capital asset, the gain or loss is considered long term, regardless of how long you held the property.

Property distributed in kind. Your basis in property distributed in kind by a decedent's estate is the same as the estate's basis immediately before the distribution plus any gain, or minus any loss, recognized by the estate. Property is distributed in kind if it satisfies your right to receive another property or amount, such as the income of the estate or a specific dollar amount. Property distributed in kind generally includes any noncash property you receive from the estate other than the following.

- A specific bequest (unless it must be distributed in more than three installments).
- Real property, the title to which passes directly to you under local law.

For information on an estate's recognized gain or loss on distributions in kind, see *Income To Include* under *Income Tax Return of an Estate—Form 1041*, later.

Other Items of Income

Some other items of income that a survivor or beneficiary may receive are discussed below. Lump-sum payments received by the surviving spouse or beneficiary of a deceased employee may represent the following.

- Accrued salary payments.
- Distributions from employee profit-sharing, pension, annuity, and stock bonus plans.
- Other items that should be treated separately for tax purposes.

The treatment of these lump-sum payments depends on what the payments represent.

Public safety officers. Special rules apply to certain amounts received due to the death of a public safety officer (a law enforcement officer, fire fighter, chaplain, or member of an ambulance crew or rescue squad).



The provisions for public safety officers apply to a chaplain killed in the line of duty after September 10, 2001, if the chaplain was responding to a fire, rescue, or police emergency as a member or employee of a fire or police department.

Death benefits. The death benefit payable to eligible survivors of public safety officers who die as a result of traumatic injuries sustained in the line of duty isn't included in either the beneficiaries' income or the decedent's gross estate. This benefit is administered through the Bureau of Justice Assistance (BJA).

The BJA can pay the eligible survivors an emergency interim benefit up to \$3,000 if it determines that a public safety officer's death

is one for which a death benefit will probably be paid. If there is no final payment, the recipient of the interim benefit is liable for repayment. However, the BJA may waive all or part of the repayment if it will cause a hardship. Any repayment waived isn't included in income.

Survivor benefits. Generally, a survivor annuity received by the spouse, former spouse, or child of a public safety officer killed in the line of duty is excluded from the recipient's income. The annuity must be provided under a government plan and is excludable to the extent that it is attributable to the officer's service as a public safety officer.

The exclusion doesn't apply if the recipient's actions were responsible for the officer's death. It also doesn't apply in the following circumstances.

- The death was caused by the intentional misconduct of the officer or by the officer's intention to cause such death.
- The officer was voluntarily intoxicated at the time of death.
- The officer was performing officer duties in a grossly negligent manner at the time of death.

Salary or wages. Salary or wages paid after the employee's death are usually taxable income to the beneficiary. See Wages, earlier, under *Specific Types of Income in Respect of a Decedent*.



If the decedent is a specified terrorist victim (see Specified Terrorist Victim, earlier), certain income received by the beneficiary or the estate isn't taxable. For more information, see [Pub. 3920](#).

Rollover distributions. An employee's surviving spouse who receives an eligible rollover distribution may roll it over tax free

into an IRA, a qualified plan, a section 403 annuity, or a section 457 plan. For more information, see Pub. 575, Pension and Annuity Income; and Form 4972, Tax on Lump-Sum Distributions.

Rollovers by nonspouse beneficiary. A beneficiary other than the employee's surviving spouse may be able to roll over all or part of a distribution from an eligible retirement plan of a deceased employee. The nonspouse beneficiary must be the designated beneficiary of the employee. The distribution must be a direct trustee-to-trustee transfer to the beneficiary's IRA set up to receive the distribution. The transfer will be treated as an eligible rollover distribution and the receiving plan will be treated as an inherited IRA. For more information on inherited IRAs, see Pubs. 590-A and 590-B.

Pensions and annuities. For beneficiaries who receive pensions and annuities, see Pub. 575. For beneficiaries of federal civil service employees or retirees, see Pub. 721, Tax Guide to U.S. Civil Service Retirement Benefits.

Inherited IRAs. If a person other than the decedent's spouse inherits the decedent's traditional IRA or Roth IRA, that person can't treat the IRA as one established on the person's behalf. If a distribution from a traditional IRA is from contributions that were deducted or from earnings and gains in the IRA, it is fully taxable income. If there were nondeductible contributions, an allocation between taxable and nontaxable income must be made. For information on distributions from a Roth IRA, see the discussion earlier under *Income in Respect of a Decedent*. The inherited IRA can't be rolled over into, or receive a rollover from, another IRA.

No deduction is allowed for amounts paid into that inherited IRA. For more information about IRAs, see Pubs. 590-A and 590-B.

Estate income. Estates may have to pay federal income tax. Beneficiaries may have to pay tax on their share of estate income. However, there is never a double tax. See *Distributions to Beneficiaries*, later.

Income Tax Return of an Estate—Form 1041

An estate is a taxable entity separate from the decedent and comes into being with the death of the individual. It exists until the final distribution of its assets to the heirs and other beneficiaries. Income earned by the decedent up to and including the date of death is included on the decedent's final Form 1040 tax return. Income received after the date of death is included on the estate's Form 1041 tax return.

The tax is generally figured in the same manner and on the same basis as for individuals, with certain differences in the computation of deductions and credits, as explained later.

The estate's income, like an individual's income, must be reported annually on either a calendar or fiscal year basis. The personal representative chooses the estate's accounting period upon filing the first Form 1041. The estate's first tax year can be any period that ends on the last day of a month and doesn't exceed 12 months.

Generally, once chosen, the tax year can't be changed without IRS approval. Also, on the first income tax return, the personal representative must choose the accounting method (cash, accrual, or other) to report the estate's income. Once a method is used, it ordinarily can't be changed without IRS approval.

For a more complete discussion of accounting periods and methods, see Pub. 538.

Filing Requirements

Every domestic estate with gross income of \$600 or more during a tax year must file a Form 1041. If one or more of the beneficiaries of the domestic estate are nonresident aliens, the personal representative must file Form 1041, regardless of the estate's gross income.

A fiduciary for a nonresident alien estate with U.S.-source income, including any income that is effectively connected with the conduct of a trade or business in the United States, must file Form 1040-NR as the income tax return of the estate.

A nonresident alien who was a resident of Puerto Rico, Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands for the entire tax year will,

for this purpose, be treated as a resident alien of the United States.

To establish Excess Deductions for the beneficiaries, a return must be filed for the estate along with a schedule showing the computation of each kind of deduction and the allocation of each to the beneficiaries.

Schedule K-1 (Form 1041)

The personal representative must file a separate Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., or an acceptable substitute (described below), for each beneficiary. File these schedules with Form 1041.

The personal representative must ask each beneficiary to provide a TIN, which must be reported on the Schedule K-1 (Form 1041). A \$50 penalty is charged for each failure to provide the identifying number of each beneficiary unless reasonable cause is established.

A nonresident alien beneficiary with a withholding certificate must generally provide a TIN (see Pub. 515). A TIN isn't required for an executor or administrator of the estate unless that person is also a beneficiary.

The personal representative must also give a Schedule K-1 (Form 1041), or a substitute, to each beneficiary by the date on which the Form 1041 is filed. Failure to provide this payee statement can result in a penalty of \$330 for each failure. This penalty also applies if information is omitted or incorrect information is included on the payee statement. If it is shown that such failure is due to intentional disregard of the filing requirement, the penalty amount increases.

No prior approval is needed for a substitute Schedule K-1 (Form 1041) that is an exact copy of the official schedule or that follows the specifications in Pub. 1167,

General Rules and Specifications for Substitute Forms and Schedules. Prior approval is required for any other substitute Schedule K-1 (Form 1041).

Beneficiaries. The personal representative has a fiduciary responsibility to the ultimate recipients of the income and the property of the estate. While the courts use a number of names to designate specific types of beneficiaries or the recipients of various types of property, this publication refers to all of them as "beneficiaries."

Liability of the beneficiary. The income tax liability of an estate attaches to the assets of the estate. If the income is distributed or must be distributed during the current tax year, the income is reportable by each beneficiary on the beneficiary's individual income tax return. If the income doesn't have to be distributed, and isn't distributed but is retained by the estate, the income tax on the income is payable by the estate.

If the income is distributed later without the payment of the taxes due, the beneficiary can be liable for tax due and unpaid to the extent of the value of the estate assets received.

Income of the estate is taxed to either the estate or the beneficiary, but not to both.

Nonresident alien beneficiary. In addition to filing Form 1041, the personal representative may need to file Form 1040-NR and pay the tax due, if any, if there is a nonresident alien beneficiary. There are a number of factors which determine whether a Form 1040-NR is required. For information on who must file Form 1040-NR, see Pub. 519, U.S. Tax Guide for Aliens.

If a nonresident alien has an appointed agent in the United States, the personal representative isn't responsible for filing Form 1040-NR and paying any tax due. However, a copy of the document appointing the agent must be attached to the estate's Form 1041.

The personal representative must also file Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, to report and transmit withheld tax on distributable net income (discussed later) actually distributed. This applies to the extent the distribution consists of an amount subject to withholding. For more information, see Pub. 515.

Amended Return

If an amended Form 1041 must be filed, use a copy of the form for the appropriate year and check the "Amended return" box. Complete the entire return, correct the appropriate lines with the new information, and refigure the tax liability. On an attached sheet, explain the reason for the changes and identify the lines and amounts changed.

Note. If the amended return results from an NOL loss carryback, check the "Net operating loss carryback" box. For more information, see the Instructions for Form 1041.

If the amended return results in a change to income, or a change in distribution of any income or other information provided to a beneficiary, an amended Schedule K-1 (Form 1041) must be filed with Form 1041 and a copy given to each beneficiary. Check the "Amended K-1" box at the top of Schedule K-1 (Form 1041).

Information Returns

Even though the personal representative may not have to file an income tax return for the estate, Form 1099-DIV, Form 1099-INT, Form 1099-MISC, or Form 1099-NEC may need to be filed if the estate received income as a nominee or middleman for another person. For more information on filing information returns, see the [General Instructions for Certain Information Returns](#).

The personal representative will **not** have to file information returns for the estate if the estate is the owner of record, Form 1041 is filed for the estate (reporting the name, address, and identifying number of each actual owner), and a completed Schedule K-1 (Form 1041) is provided to each actual owner.

Penalty. A penalty of up to \$330 can be charged for each failure to file or failure to include correct information on an information return. (Failure to include correct information includes failure to include all the information required.) If it is shown that such failure is due to intentional disregard of the filing requirement, the penalty amount increases. See the [General Instructions for Certain Information Returns](#) for more information.

Copy of the Will

The personal representative does **not** have to include a copy of the decedent's will with Form 1041.

If the will is later requested, attach a statement to it indicating the provisions that determine how much of the estate's income is taxable to the estate or to the beneficiaries. A statement signed by the personal representative under penalties of perjury that the will is a true and complete copy should also be attached.

Income To Include

The estate's taxable income is generally figured the same way as an individual's income, except as explained in the following discussions.



If the decedent is a specified terrorist victim (see Specified Terrorist Victim, earlier), certain income received by the estate isn't taxable. See [Pub. 3920](#).

Gross income of an estate consists of all items of income received or accrued during the tax year. It includes dividends, interest, rents, royalties, gain from the sale of

property, and income from business, partnerships, trusts, and any other sources. For a discussion of income from dividends, interest, and other investment income, as well as gains and losses from the sale of investment property, see Pub. 550, Investment Income and Expenses. For a discussion of gains and losses from the sale of other property, including business property, see Pub. 544, Sales and Other Dispositions of Assets.

If the personal representative's duties include the operation of the decedent's business, see Pub. 334. That publication provides general information about the tax laws that apply to a sole proprietorship.

Income in respect of a decedent. The personal representative of the estate may receive income the decedent would have reported had death not occurred. For an explanation of this income,

see *Income in Respect of a Decedent* under *Other Tax Information*, earlier. An estate may qualify to claim a deduction for estate taxes if the estate must include in gross income for any tax year an amount of income in respect of a decedent. See *Estate Tax Deduction* under *Other Tax Information*, earlier.

Gain (or loss) from sale of property.

During the administration of the estate, the personal representative may find it necessary or desirable to sell all or part of the estate's assets to pay debts and expenses of administration, or to make proper distributions of the assets to the beneficiaries. While the personal representative may have the legal authority to dispose of the property, title to it may be vested (given a legal interest in the property) in one or more of the beneficiaries. This is usually true of real property.

To determine whether any gain or loss must be reported by the estate or by the beneficiaries, consult local law to determine the legal owner.

Redemption of stock to pay death taxes.

Under certain conditions, a distribution to a shareholder (including the estate) in redemption of stock included in the decedent's gross estate may be allowed capital gain (or loss) treatment.

Character of asset. The character of an asset in the hands of an estate determines whether gain or loss on its sale or other disposition is capital or ordinary. The asset's character depends on how the estate holds or uses it. If it was a capital asset to the decedent, it will generally be a capital asset to the estate. If it was land or depreciable property used in the decedent's business and the estate continues the business, it will generally have the same character to the estate that it had in the decedent's hands.

If it was held by the decedent for sale to customers, it will generally be considered to be held for sale to customers by the estate if the decedent's business continues to operate during the administration of the estate.



The gain from a sale of depreciable property between an estate and a beneficiary of that estate will be treated as ordinary income, unless the sale or exchange was made to satisfy a pecuniary (cash) bequest.

Sale of decedent's residence. If the estate is the legal owner of a decedent's residence and the personal representative sells it in the course of administration, the tax treatment of gain or loss depends on how the estate holds or uses the former residence. For example, if, as the personal representative, you intend to realize the value of the house through sale, the residence is a capital asset held for investment and gain or loss is capital gain or loss (which may be deductible).

This is the case even though it was the decedent's personal residence and even if you didn't rent it out. If, however, the house isn't held for business or investment use (for example, if you intend to permit a beneficiary to live in the residence rent free and then distribute it to the beneficiary to live in), and you later decide to sell the residence without first converting it to business or investment use, any gain is capital gain, but a loss isn't deductible.

Holding period. An estate (or other recipient) that acquires property from a decedent and sells or otherwise disposes of it is considered to have held that property for more than 1 year, no matter how long the estate and the decedent actually held the property.

Basis of property. The basis used to figure gain or loss for property the estate receives from the decedent is usually its FMV at the date of death.

See *Basis of Inherited Property* under *Other Tax Information*, earlier, for other basis in inherited property.

If the estate purchases property after the decedent's death, the basis will generally be its cost.

The basis of certain appreciated property the estate receives from the decedent will be the decedent's adjusted basis in the property immediately before death. This applies if the property was acquired by the decedent as a gift during the 1-year period before death, the property's FMV on the date of the gift was greater than the donor's adjusted basis, and the proceeds of the sale of the property are distributed to the donor (or the donor's spouse).

Schedule D (Form 1041) and Form 8949.

Use Form 8949, Sales and Other Dispositions of Capital Assets, to report most sales and exchanges of capital assets. Use Schedule D (Form 1041), Capital Gains and Losses, to

report the overall capital gains and losses from transactions reported on Form 8949, certain transactions that don't have to be reported on Form 8949, and certain other capital gains and losses. For additional information, see the Instructions for Form 8949 and the Instructions for Schedule D (Form 1041).

Installment obligations. If an installment obligation owned by the decedent is transferred by the estate to the obligor (buyer or person obligated to pay) or is canceled at death, include the income from that event in the gross income of the estate. See *Installment obligations* under *Income in Respect of a Decedent*, earlier. See Pub. 537 for information about installment sales.

Gain from sale of special-use valuation property. If the personal representative elected special-use valuation for farm or other closely held business real property and that property is sold to a qualified heir, the estate

will recognize gain on the sale if the FMV on the date of the sale exceeds the FMV on the date of the decedent's death (or on the alternate valuation date if it was elected).

Qualified heirs. Qualified heirs include the decedent's ancestors (parents, grandparents, etc.) and spouse, the decedent's lineal descendants (children, grandchildren, etc.) and their spouses, and lineal descendants (and their spouses) of the decedent's parents or spouse. For more information about special-use valuation, see Form 706 and its instructions.

Gain from transfer of property to a political organization. Appreciated property transferred to a political organization is treated as sold by the estate. Appreciated property is property that has an FMV (on the date of the transfer) greater than the estate's basis. The gain recognized is the difference between the estate's basis and the FMV on the date transferred.

A political organization is any party, committee, association, fund, or other organization formed and operated to accept contributions or make expenditures for influencing the nomination, election, or appointment of an individual to any federal, state, or local public office.

Gain or loss on distributions in kind. An estate recognizes gain or loss on a distribution of property in kind to a beneficiary only in the following situations.

1. The distribution satisfies the beneficiary's right to receive either of the following.
 - a. A specific dollar amount (whether payable in cash, in unspecified property, or in both).
 - b. A specific property other than the property distributed.

2. An election is made to recognize the gain or loss on the estate's income tax return (section 643(e)(3) election).

The gain or loss is usually the difference between the FMV of the property when distributed and the estate's basis in the property. However, see *Gain from sale of special-use valuation property*, earlier, for a limit on the gain recognized on a transfer of such property to a qualified heir.

If you elect to recognize gain or loss, the election applies to all noncash distributions during the tax year except charitable distributions and specific bequests. To make the election, report the transaction on Form 8949 and/or Schedule D (Form 1041), as applicable, and check the box on Form 1041, Other Information, line 7. The election must be made by the due date (including extensions) of the estate's income tax return for the year of distribution.