
Navigating the §645 Election

by Jordan M. Wassel, Esq. of Schenck Price Smith & King, LLP

Quite often, first time Executors are blissfully unaware that even after death, the assets of a decedent will continue to be subject to income tax.

Not only is a decedent's estate typically required to file a fiduciary income tax return (Form 1041) but a revocable trust that is part of a decedent's estate plan will also typically be required to file its own fiduciary income tax return.

Very often, and for a number of different reasons, a decedent's estate plan may utilize a "pour-over" last will and testament and a revocable living trust as the cornerstone of the estate plan rather than solely a comprehensive last will and testament.

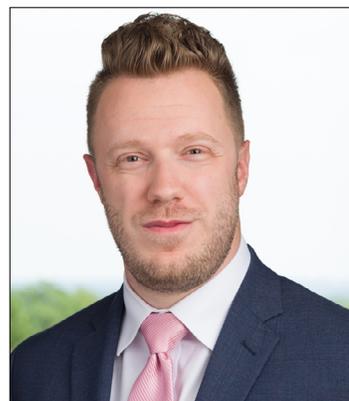
In that case, rather than file two separate fiduciary income tax returns (one for the estate and one for the revocable living trust), the executor of the estate and the trustee of the revocable living trust can make what is known as a §645 election (since it is codified in Internal Revenue Code §645) which allows the revocable living trust to be treated and taxed as part of its related estate during the election period. One fiduciary tax return, instead of two!

The Advantages of the §645 Election

While there is the obvious advantage of filing just one fiduciary tax return between the two entities, there are numerous other advantages of making a §645 election.

From a pure fiduciary tax return perspective, the §645 election also allows for a fiscal year filing as opposed to a calendar year filing. Trusts are required to be filed on a calendar year basis, however when a §645 election is made and the revocable living trust is treated as part of the estate, and because the estate may utilize a fiscal year basis, the combined return may then also utilize the fiscal year basis. This flexibility is often very helpful to fiduciaries, especially when the decedent dies towards the end of the year. For example, if a decedent dies in October, rather than needing to quickly scramble to get a fiduciary income return filed by April 15th to cover the period from October to December, the fiduciary would now be able to utilize a fiscal year of October to September, granting much more time to process, evaluate, and ultimately file.

Another procedural benefit allowed by the §645 election is the relaxed requirement for estimated tax payments. Because estates are exempt from making estimated tax payments for two years from the decedent's date of death, treating the revocable living trust as part of the estate extends this advantage to the combined filing.



Jordan M. Wassel, Esq.

Procedure for making a §645 Election

To be eligible for the §645 election, a revocable living trust must be a “Qualified Revocable Trust.” This means that the trust, on the decedent’s death, was treated as owned by the decedent under §676 of the Internal Revenue Code by reason of a power to revoke the trust exercisable by the decedent.

In order to make the §645 election, the executor and the trustee will complete, sign, and file Form 8855 with the IRS. Additionally, on the first filed fiduciary income tax return, the box will need to be checked on item G that a §645 election was made. The first fiduciary income tax return, in general, is due on the fifteenth day of the fourth month after the close of the initial tax year for the related estate. While fiduciary income tax returns for an estate have a filing threshold, where the income must exceed \$600, this filing threshold does not apply to §645 elections. This means that even if the income on the fiduciary income tax return for the first year does not exceed \$600, to make a proper §645 election, the return would still need to be filed to “check the box.”

It is also important to remember that once the election is made, it is irrevocable.

The Election Period

When a §645 election is made, it is not permanent. While an estate administration may remain ongoing for many years, the §645 election will only be effective during the “election period.” The election period is defined as the period of time during which an electing trust is treated and taxed as part of its related estate.

The election period begins on the decedent’s date of death and ends on the earlier of (i) the day on which the electing trust and estate have distributed all of their assets or (ii) the day before the “applicable date.” So as long as the estate/trust administration is still on-going, the applicable date will likely control.

The applicable date hinges on whether a United States Estate (and Generation-Skipping) Tax Return (Form 706) is required to be filed. If Form 706 is not required to be filed, the election period is two years from the decedent’s date of death. If Form 706 is required to be filed, the applicable date is the later of (i) two years from the decedent’s date of death or (ii) six months after the “final determination of liability for estate tax”.

Of course, that begs the question, what constitutes the final determination of liability for estate tax? For §645 election purposes, the final determination of liability for estate tax is the earlier of (i) six months after the IRS issues an estate tax closing letter (ii) the final disposition of a claim for refund that resolves the liability for estate tax (iii) the execution of a settlement agreement with the IRS that determines the liability for estate tax (iv) the issuance of a decision, judgment, decree, or other order by a court of competent jurisdiction resolving the liability for the estate tax, or (v) the expiration of the period of limitations for the estate tax.

In layman’s terms, the final determination of liability for estate tax is exactly as it sounds, when there is no longer a question as to how much estate tax is owed by an estate; in most estate administrations this is typically denoted by the receipt of the estate tax closing letter. As a side note, estate tax closing letters are not automatically issued by the IRS; the estate must affirmatively request the closing letter and not earlier than 9 months from the date that Form 706 is filed.

To summarize, if Form 706 is not required, the §645 election will run for a maximum of two years, and if Form 706 is required, the §645 election will run for, generally, a period of time from the decedent’s date of death through the date six months after an estate tax closing letter is received—that timing will be heavily influenced on whether or not the estate is subject to IRS audit and if so, how long it takes to complete the audit process.

When the election period ends, the estate can continue to file on a fiscal year basis, but the electing trust will need to begin filing its own fiduciary income tax returns, separate from the estate’s fiduciary income tax returns—remembering that those subsequent trust fiduciary tax returns would need to be filed on a calendar year basis.

Conclusion

When a decedent dies with an estate plan utilizing a revocable living trust, the §645 election is likely an important and advantageous procedural step. Its benefits allow for a more streamlined fiduciary income tax compliance. However, when estate administrations continue over numerous years, it is critical, if a §645 election has been made, to understand the rules for determining the election period. The §645 election does not last forever and if an Executor is faced with administration issues that delay final distribution of assets, the election period may end before the estate administration is completed.

Jordan M. Wassel is a member of Schenck Price Smith & King's Estate, Gift & Charitable Planning and Elder and Special Needs Practice Groups. He focuses his practice on estate planning and estate administration. He can be reached at jmw@spsk.com.