



December 16, 2022

The Honorable Lily Batchelder
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Department of the Treasury
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RE: Suggested Updates to Form 1041 to Facilitate Electronic Filing, Foreign Tax Credits and Passive Foreign Investment Companies

Dear Assistant Secretary Batchelder, Principal Deputy Chief Counsel Paul, and Ms. Porter:

The American Institute of CPAs (AICPA) is submitting comments to the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) recommending updates to Form 1041, U.S. Income Tax Return for Estates and Trusts, to facilitate the electronic filing of that form.

Overview

Taxpayers have experienced challenges in electronically filing Form 1041 because the design of the form has not kept pace with the complexity of the Internal Revenue Code,¹ particularly with respect to international taxation. Specifically, there are multiple additions to the filer’s tax liability related to international tax provisions for which there is no guidance (in either the form or instructions) as to where reporting should take place on Form 1041.

In the absence of guidance for reporting, taxpayers are forced to improvise by writing these additions to tax onto Form 1041, often with a statement attached explaining the addition. These improvised “write-in” items can make it more difficult to electronically file Form 1041 or even preclude electronic filing altogether, as the IRS electronic filing system is not designed to accept manual changes to Form 1041. In addition, these “write-in” items can make it more difficult for

¹ Unless otherwise indicated, references to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”), and references to a “Treas. Reg. §” are to the Treasury regulations promulgated under the Code.

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the IRS to process paper-filed Forms 1041, as Campus personnel must interpret the non-standardized changes that taxpayers have made to the form.

Recommendations

Treasury and the IRS should update Form 1041, Schedule G, Line 8 to include among the “other taxes and amounts due” reported therein the following items:

1. Tax owed after foreign tax credits pursuant to an election under section 962 (election made by a domestic shareholder of a controlled foreign corporation to be taxed at corporate rates);
2. The aggregate increases in taxes pursuant to section 1291(c)(2) with respect to distributions from, and dispositions of, stock in a section 1291 fund (currently reported on Form 8621, Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund, line 16e);
3. The aggregate amount of interest charges pursuant to section 1291(c)(3) on the aggregate increases in taxes pursuant to section 1291(c)(2) with respect to a section 1291 fund (currently reported on Form 8621, line 16f); and
4. Accrued interest due upon the termination of an election to defer undistributed PFIC earnings tax liability under section 1294 (currently reported on Form 8621, line 24).

Analysis

Pursuant to section 641(b), the income taxation of estates and trusts is based upon the taxation of individuals, with special modifications under the Internal Revenue Code. Nevertheless, from a reporting standpoint, there are multiple examples of additions to tax related to international provisions for which guidance is provided to individuals in Form 1040, U.S. Individual Income Tax Return, but no such guidance is provided to estates and trusts in Form 1041. The lack of guidance for reporting these items creates the electronic filing difficulties as noted above. A few such items are described in more detail below.

By updating Form 1041, Schedule G, Line 8 to provide for these items, and the related instructions, Treasury and the IRS would provide greater clarity to taxpayers regarding the methodology for reporting. Also, the update would facilitate electronic filing of returns reporting these items, thereby reducing the time and effort that would otherwise be required for the IRS to process such returns in filed in paper form. This incremental change would not require a significant update to the existing Form 1041 (*e.g.*, addition of a new line or schedule). Instead, it would just require a change to the coding for Schedule G, Line 8 (*e.g.*, the ability to note “962” next to line 8 for tax under section 962) and an update to the instructions.

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Tax under Section 962

Section 962 provides that an individual who is a United States shareholder of a controlled foreign corporation may elect to have the tax imposed under chapter 1 on amounts that are included in the individual's gross income under section 951(a) be an amount equal to the tax that would be imposed under section 11 if such amounts were received by a domestic corporation. Additionally, if an election is made under section 962, the amounts included in the individual's gross income under section 951(a) are treated as if they were received by a domestic corporation for purposes of applying section 960 (relating to foreign tax credits).² Pursuant to Treas. Reg. §1.962-2(a), an estate or trust may make an election under section 962 if it is a United States shareholder of a controlled foreign corporation.

The tax with respect to a section 962 election is calculated separately from the rest of the filer's income tax return.³ Any tax at corporate rates under a section 962 election after foreign tax credits claimed on Form 1118 ("residual section 962 tax") must thus be entered as an addition to the filer's tax liability.

Since 2011, the instructions for Form 1040 have provided guidance to individuals on the reporting of residual section 962 tax. However, neither Form 1041 nor the related instructions address how to report residual section 962 tax owed by estates or trusts. One approach is to note the additional tax in a statement attached to Schedule G, Line 9. However, this can cause rejections of electronically filed returns, as the total tax reported on Schedule G, Line 9, will not match the total of Schedule G, Lines 3-8 as the form directs.

Based upon the enactment of sections 951A and 250 in 2017 and the related revisions to the section 962 regulations, section 962 elections have become much more common than they were under prior law. Forms 1041 with section 962 elections can include voluminous international information reporting forms and schedules, and it would benefit the IRS to avoid the manual processing of such returns submitted in paper form.

Additions to Tax and Interest Charges under Section 1291

Section 1291 provides special rules that apply to distributions from, and dispositions of, stock in a passive foreign investment company (PFIC) which is neither a pedigreed Qualified Electing Fund (QEF) nor for which a section 1296 election is in effect with respect to the shareholder (*i.e.*, a section 1291 fund).

Under section 1291(a)(1)(C), the portion of the excess distribution that is allocated to prior PFIC years is not included in the shareholder's gross income but is instead subject to a "deferred tax amount." Pursuant to section 1291(c)(1), the deferred tax amount consists of i) the aggregate

² See 83 Federal Register 39514, 39518-39519 (August 9, 2018).

³ Treas. Reg. §1.962-1(c).

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increases in tax determined for each portion of an excess distribution allocated to a prior PFIC year (“aggregate increases in tax”), and ii) the sum of the interest charges computed on all net increases in tax calculated for an excess distribution (“aggregate interest charges”). Each increase in tax is determined by multiplying the amount of the excess distribution allocated to the prior PFIC year by the highest statutory rate of tax in effect under either section 1 or section 11, as applicable, for that prior PFIC year.⁴

The aggregate increases in tax and the aggregate interest charges must be added to the tax liability of the filer.⁵ Currently, Form 1040 provides that the aggregate increases in tax are reported on Line 16 and the aggregate interest charges are reported on Schedule 2, Line 17p. No guidance has been provided for reporting these amounts on Form 1041. Section 1291 funds are commonly seen, particularly through reporting from Schedules K-1 and K-3 issued by partnerships. Thus, it would be helpful for estates and trusts to have clear direction for reporting the aggregate increases in tax and aggregate interest charges.

Accrued Interest due under Section 1294

Section 1294 allows a U.S. person that is a shareholder in a qualified electing fund to elect to extend the time for payment of its tax liability which is attributable to its share of the undistributed earnings of the QEF.⁶ Interest is computed using the rates and methods under section 6621 on the amount of the tax liability that is subject to the extension.⁷ Interest accrues beginning on the due date (without regard to extensions) of the tax return for the tax year in which the section 1294 election is made and ending with the due date (without regard to extensions) of the tax return for the tax year of the termination. This interest must be paid on the termination of the election.⁸

Currently, Form 1040 provides that the accrued interest due upon termination of an election under section 1294 is reported on Schedule 2, Line 17q. No guidance has been provided for reporting these amounts on Form 1041.

The AICPA is the world’s largest member association representing the CPA profession, with more than 421,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America’s largest businesses.

⁴ Prop. Reg. §1.1291-4(c)(1).

⁵ Prop. Reg. §1.1291-4(b).

⁶ Treas. Reg. §1.1294-1T(a).

⁷ Section 1294(g); Treas. Reg. §1.1294-1T(b)(1).

⁸ *Id.*

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We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. If you have any questions, please contact Irene Estrada, Chair, AICPA Trust, Estate, and Gift Tax Technical Resource Panel, at (703) 628-5243 or irene.c.estrada@pwc.com; Eileen Sherr, AICPA Director — Tax Policy & Advocacy, at (202) 434-9256 or Eileen.Sherr@aicpa-cima.com; or me at (601) 326-7119 or JanLewis@HaddoxReid.com.

Sincerely,

A handwritten signature in black ink, appearing to read "Jan Lewis". The signature is fluid and cursive, with a large initial "J" and "L".

Jan Lewis, CPA
Chair, AICPA Tax Executive Committee

cc: Ms. Catherine Hughes, Estate and Gift Tax Attorney-Advisor, Office of Tax Legislative Counsel, Office of Tax Policy, Department of the Treasury
Mr. Peter Blessing, Associate Chief Counsel (International), Internal Revenue Service
Mr. Daniel McCall, Deputy Associate Chief Counsel International (Technical), Internal Revenue Service