



November 25, 2020

Kinna Brewington
Internal Revenue Service
Room 6129
1111 Constitution Ave. NW
Washington, DC 20224

Comments on Form 1040-NR as it Relates to Foreign Trusts and Estates

Dear Ms. Brewington:

This letter responds to the request for comments concerning the burden associated with US income tax return forms for individual taxpayers. This letter provides comments specifically on the burden associated with Form 1040-NR (US Nonresident Alien Income Tax Return) as it relates to foreign trusts and estates.

On October 30, 2020, the IRS published a notice and request for comments in the Federal Register.¹ The notice formally invited the public to provide comments under the Paperwork Reduction Act of 1995 with respect to the burden associated with US income tax return forms for individual taxpayers. More specifically, the IRS requested comments on how to minimize the burden of collection of information (including using appropriate electronic and/or technological collection techniques). Form 1040-NR was specifically listed as one of the forms for which comments were requested.

An early-release draft of Form 1040-NR was issued on November 4, 2020. The transmittal for the form states that comments on the draft can be submitted to the IRS. This letter is intended to also provide comments under that more general request.

Trusts and estates are both subject to income tax. Domestic trusts and estates are required to file their income tax return on Form 1041 (US Income Tax Return for Estates and Trusts). Foreign trusts and estates are required to file their income tax return on Form 1040-NR, a form that was designed primarily for nonresident alien individuals.

The requirement for foreign trusts and estates to use a form that was not designed primarily for their use results in difficulties in complying with the filing requirements and unnecessary costs. Additional compliance costs and difficulties include (i) having to use two different software modules (one for nonresident alien individuals and one for trusts and estates) to process the return, and (ii) the inability to file the return electronically.

To provide for easier return preparation for foreign trusts and estates, we recommend that such taxpayers be permitted to file their returns on Form 1041, a form designed for domestic trusts and estates. This will allow such taxpayers to use a single software module for both federal and state returns and to electronically file such returns. Only minimal changes to Form 1041 will be necessary to allow this change to occur.

TAX RETURN COMPLIANCE RULES

Trusts and estates are generally subject to income tax on their taxable income.² Foreign trusts and estates are generally subject to income tax if they (i) receive fixed or determinable annual or periodical (FDAP)

¹ 85 FR 68956 (2020)

² IRC §§ 1(e), 641(a).

income from US sources, or (ii) have income that is effectively connected with a US trade or business (ECI).³

Taxpayers (including trusts and estates) are generally required to file a tax return when required by regulations or statute. Such a return is required to be filed according to forms and regulations prescribed by the IRS or the Treasury Department.⁴

Trusts and estates are required to file an income tax return if they have gross income of \$600 or more or they have a beneficiary that is a nonresident alien. In addition, trusts (but not estates) are required to file an income tax return if they have any taxable income.⁵ Foreign trusts and estates may be exempted from the filing requirement pursuant to regulations if their income subject to tax consists only of FDAP income.⁶

Regulations have not been promulgated regarding the income tax return filing requirements of foreign trusts and estates. In addition, the instructions for Form 1040-NR do not discuss the income tax return filing requirements for a foreign trust or estate.

The IRS has taken the position in several letter rulings that the regulations regarding nonresident alien individuals also apply to foreign trusts and estates.⁷ A nonresident alien individual is generally required to file an income tax return if he is engaged in a trade or business in the US at any time during the taxable year or has income that is subject to tax under subtitle A of the Code (income taxes). For purposes of this requirement, it is immaterial that (i) gross income is less than the minimum normally required for a citizen or resident to have a filing requirement, (ii) there is no income from ECI, (iii) there is no income from US sources, (iv) all of the income is exempt from tax under an income tax treaty, or (v) there is no gross income. However, if the nonresident alien individual has no gross income during the taxable year, then a return with reduced required schedules is permitted.⁸ A nonresident alien individual is generally not required to file an income tax return if (i) he was not engaged in a trade or business in the US at any time during the taxable year, and (ii) his tax liability for the taxable year is fully satisfied by withholding under chapter 3 of subtitle A of the Code (withholding of tax on nonresident aliens and foreign corporations).⁹

Trusts and estates are also required to file information returns with respect to their beneficiaries. These returns are required if the trust or estate is required to file a tax return. In such case, a statement (on Schedule K-1) must be furnished to each beneficiary who receives a distribution (or is allocated any item of income, deduction, gain, or loss) during the taxable year.¹⁰

³ IRC § 871(a), (b).

⁴ IRC § 6011(a); Treas. Reg. § 1.6011-1(a), (b).

⁵ IRC § 6012(a)(3-5); Treas. Reg. § 1.6012-3(a).

⁶ IRC § 6012(a).

⁷ CCA 201432022 (July 25, 2014) (filing requirement of a dual status trust); PLR 7917063 (Jan. 25, 1979) (same); PLR 7917037 (Jan. 24, 1979) (same). It is possible that this position is based on section 641(b) of the Internal Revenue Code of 1986, as amended (the “Code”). Section 641(b) provides that a foreign trust or estate is treated as a nonresident alien individual who is not present in the United States at any time for purposes of computing the taxable income of the trust or estate.

⁸ Treas. Reg. § 1.6012-1(b)(1)(i).

⁹ Treas. Reg. § 1.6012-1(b)(2)(i).

¹⁰ IRC § 6034A(a).

The tax and information returns of a trust or estate are filed by a fiduciary on behalf of the trust or estate.¹¹ Similarly, the fiduciary has the obligation to pay any tax (or other amounts) due on behalf of the trust or estate.¹²

The applicable regulations specify the income tax return forms to be filed by individuals, corporations, and domestic trusts and estates,¹³ but do not specify the forms to be filed by foreign trusts and estates. Applicable form instructions provide that fiduciaries of foreign trusts and estates should file their income tax returns on Form 1040-NR.¹⁴

ELECTRONIC FILING REQUIREMENTS

Tax return preparers are generally required to file all income tax returns of individuals, trusts, and estates electronically.¹⁵ The IRS may provide administrative exemptions from certain classes of tax preparers or certain types of tax returns.¹⁶

Notice 2011-26¹⁷ lists various administrative exemptions from the e-file requirement. Form 1040-NR was exempted from the electronic filing requirement by Notice 2011-26 since (at the time) the IRS was not accepting such returns electronically.¹⁸

Earlier this year, the IRS modified Notice 2011-26 to generally allow and require Form 1040-NR to be electronically filed.¹⁹ Generally, electronic filing will be mandatory for taxable years ending on or after December 31, 2020.²⁰ However, tax returns of foreign trusts and estates continue to be exempt from the electronic filing requirement. In addition, the IRS has announced that it is continuing the policy of not accepting returns of foreign trusts and estates filed electronically.²¹

COMMENTS ON FORM 1040-NR

Below are comments related to the applicability of Form 1040-NR to foreign trusts and estates. Domestic trusts and estates have a standalone form (Form 1041). Foreign trusts and estates are required to use Form 1040-NR, which is designed for the use of (and primarily used by) nonresident aliens.

We recommend that the IRS allow foreign trusts and estates to file their income tax returns on Form 1041, a form better suited for the purpose than Form 1040-NR. Since the requirement to file on Form 1040-NR is found only in a form instruction (and not in a regulation), we believe that the IRS has the authority to change the form that is filed by foreign trusts and estates. The change could be made as an optional method of filing for foreign trusts and estates.

¹¹ IRC §§ 641(b), 6012(b)(4), 6034A(a); Treas. Reg. §§ 1.641(b)-2(a); 1.6012-3(a)(1); *Holywell Corp. v. Smith*, 503 US 47 (1992).

¹² IRC § 6903(a); Treas. Reg. §§ 1.641(b)-2(a); 301.6903-1(a); *Holywell*.

¹³ Treas. Reg. §§ 1.6012-1(a)(6) (citizens and residents), (b) (nonresident aliens), -2(a)(3) (domestic corporations), (g) (foreign corporations), -3(a)(1) (domestic trusts and estates).

¹⁴ IRS, Instructions for Form 1041 (2019), p. 5; IRS, Instructions for Form 1040-NR (2019), p. 7-8.

¹⁵ IRC § 6011(e)(3); Treas. Reg. §§ 1.6011-7, 301.6601-7.

¹⁶ Treas. Reg. § 301.6601-7(c)(2).

¹⁷ 2011-1 CB 720.

¹⁸ Notice 2011-26, p. 7.

¹⁹ Notice 2020-70, 2020-43 IRB 913.

²⁰ Notice 2020-70, p. 3.

²¹ Notice 2020-70, p 3-4.

The current requirement for foreign trusts and estates to file returns on Form 1040-NR adds a great amount of complexity to the compliance process. Although there are very significant differences between how nonresident aliens and foreign trusts and estates are taxed (e.g., foreign trusts and estates are entitled to a deduction for distributions to beneficiaries), the instructions for Form 1040-NR only provide sparse information as to how the form should be completed by foreign trusts and estates. The applicable instructions state that a foreign trust or estate, should “change the form to reflect the provisions of subchapter J, chapter 1, of the Internal Revenue Code. You may find it helpful to refer to Form 1041 and its instructions when completing the Form 1040-NR.”²²

The bigger problem with using Form 1040-NR for foreign trusts and estates is that certain Form 1041 schedules are required to be attached. This results in a “Frankenstein” type of return that is problematic for preparers that are trying to use computer software to prepare the return. As a result, the Form 1040-NR is prepared using the individual module of the software, but certain schedules are prepared using the trust module of the software. (These schedules from different modules do not mesh well.) In addition, the state returns are prepared exclusively using the trust module (since state and local income tax returns are filed on forms designed exclusively for trusts).

As an illustration, below are the forms and schedules (and their source) that would commonly be included on Form 1040-NR filed by a foreign trust or estate.

- Form 1040-NR – Individual module
- Schedule A (Itemized Deductions) – Individual module
- Schedule B (Income Distribution Deduction) – Trust module
- Schedule D (Capital Gains and Losses) – Trust module
- Schedule I (Alternative Minimum Tax) – Trust module
- Schedule J (Accumulation Distribution For Certain Complex Trusts) – Trust module
- Schedule K-1 (Beneficiary’s Share of Income, Deductions, Credits, etc.) – Trust module
- Schedule NEC (Tax on Income Not Effectively Connected With a US Trade or Business) – Individual module
- Schedule OI (Other Information) – Individual module

In many cases, the majority of the forms and schedules on a tax return for a foreign trust or estate are forms relating to Form 1041.

We recommend allowing foreign trusts and estate to file their income tax returns on Form 1041, a form that is better suited to the purpose than Form 1040-NR. It is possible that this change might require added schedules to take into account foreign and domestic differences. However, we believe that only Schedule NEC (or an equivalent) would be required to be added. In addition, a box would need to be added to Item A of Form 1041 to reflect the foreign status of the taxpayer. It should be noted that domestic and foreign partnership share a single tax form (Form 1065), so there is a precedent for this solution.

Currently, foreign trusts and estates are required to file Schedule OI. This is an informational questionnaire. Most of the questions on the form relate exclusively to nonresident alien individuals. Only item J is related to trusts and estates. Item J asks whether a trust is a grantor trust and, if so, whether certain specified transactions with a US person occurred. This question could be added to the “Other Information” schedule of Form 1041.

²² Instructions for Form 1040-NR (2019), p.8.

If the IRS were to allow foreign trusts and estates to file on Form 1041, it is expected that software vendors would be able to develop easy to use tax preparation modules for foreign trusts and estates. This would drastically reduce the current compliance costs for such taxpayers.

Ideally, we would have recommended that the IRS develop a stand-alone form for foreign trusts and estates (e.g., Form 1041-F). However, in the interest of time and taking into account the current staffing issues, we have not proposed a new form. We are hoping a switch to Form 1041 could be rolled out in time for the 2021 tax season.

Currently, foreign trusts and estates are not able to file electronically since the available software programs cannot support electronic filing (even if the IRS approved it). This is a result of having to prepare the returns using two different software modules (one for Form 1040-NR and one for Form 1041). It is expected that if foreign trusts and estates are permitted to file on Form 1041, then the software vendors (and the IRS) would allow them to electronically file their income tax returns.

The inability to file electronically is a great source of difficulties (and added compliance costs) for foreign trusts and estates. It is not a simple matter for a foreign trust or estate to file a paper return due to lack of access to the US Postal Service. (Private delivery services are available.). However, practitioners generally mail returns on behalf of the taxpayer (based on the general unfamiliarity of foreign taxpayers with the US tax filing procedures). Since the IRS does not allow facsimile signatures on returns (the so-called “wet ink signature rule”), returns have to be finalized several weeks before the due date to allow for the client’s signature to be mailed to the practitioner’s office in the US.

No state or local jurisdiction (that we are aware of) follows the federal requirement that foreign trusts and use a form designed for individuals. All such jurisdictions require the use of a form designed exclusively for trusts and estates. Allowing foreign trusts and estates to file a return on Form 1041 would allow such taxpayers to use a single software module to produce both federal and state income tax returns. This would also reduce the current compliance costs for such taxpayers.

We would be more than happy to discuss these issues with you at a convenient time.

Best regards,



Lee G. Zimet