

Part III

Administrative, Procedural, and Miscellaneous

Estimated Tax Election for Owners of ESBTs

Notice 2001-25

PURPOSE AND BACKGROUND

This notice provides guidance to electing small business trusts (ESBTs) and individuals who are treated as the owners of ESBTs (deemed owners) under subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code (subpart E), regarding estimated tax payments mistakenly made by ESBTs rather than the deemed owners of the ESBTs for taxable years ending on December 29, 30, or 31, 2000. Questions have arisen whether these estimated tax payments made by ESBTs (under the ESBTs' employer identification numbers (EINs)) for the 2000 taxable year can be credited to the accounts of the deemed owners of the ESBTs, and whether any penalties for underpayment of estimated tax are applicable.

Proposed Income Tax Regulations under § 1361(e) and § 641(c) were published in the Federal Register on December 29, 2000 (65 Fed. Reg. 82963) providing guidance with respect to ESBTs. Section 1.641(c)-1(a) provides that an ESBT is treated as two separate trusts for purposes of determining income tax. The portion of

an ESBT that consists of stock in one or more S corporations (the S portion) is treated as one trust. The portion of an ESBT that consists of all the other assets in the trust is treated as a separate trust. The grantor or another person may be treated as the owner of all or a portion of either or both trusts under subpart E (grantor portion).

Section 1.641(c)-1(c) provides that the grantor or another person who is treated as the owner of a portion of the ESBT includes in computing taxable income items of income, deductions, and credits against tax attributable to that portion of the ESBT under § 671.

Section 1.641(c)-1(j) provides that § 1.641(c)-1(a), (b), and (c) are proposed to be applicable for taxable years of ESBTs that end on and after December 29, 2000.

Prior to the issuance of the proposed ESBT regulations, some taxpayers took the position that an ESBT election could be made for a grantor trust and that the rules relating to the taxation of ESBTs applied to the entire portion of the trust holding S corporation stock. Consistent with this position, these ESBTs made estimated tax payments for the 2000 taxable year under the trusts' EINs, and the deemed owners did not take into account the S corporation income in calculating their estimated tax payments for the 2000 taxable year.

Section 6654(a) provides that except as otherwise provided in § 6654, in the case of any underpayment of estimated tax by an individual, there shall be added to the tax under chapter 1 and the tax under chapter 2 for the taxable year an amount determined by applying (1) the underpayment rate established by § 6621, (2) to the amount of the underpayment, (3) for the period of the underpayment.

Section 6654(d)(2)(B) provides that in the case of any required installment, the annualized income installment is the excess of (i) the amount equal to the applicable percentage of the tax for the taxable year computed by placing on an annualized basis the taxable income, alternative minimum taxable income, and adjusted self-employment income for months in the taxable year ending before the due date for the installment, over (ii) the aggregate amount of any prior required installments for the taxable year.

Section 6654(e)(3)(A) provides that no addition to tax shall be imposed under § 6654(a) with respect to any underpayment to the extent the Secretary determines that by reason of casualty, disaster, or other unusual circumstances the imposition of such addition to tax would be against equity and good conscience.

SCOPE

This notice provides a method for having the estimated tax payments that were made by an ESBT under the trust's EIN credited to the deemed owner's account for estimated tax purposes. This notice also provides that for purposes of the deemed owner's computation of annualized income installments under § 6654(d)(2)(B), the deemed owner may take into account, as of the last day of the deemed owner's 2000 taxable year, the S corporation pass-thru items allocable to stock held by the ESBT.

METHOD FOR CREDITING ESTIMATED TAX PAYMENTS TO DEEMED OWNER AND CALCULATING ANY UNDERPAYMENT OF ESTIMATED TAX PENALTY

An ESBT that wants estimated tax payments that were made by the trust under the trust's EIN to be treated as made by the deemed owner of the ESBT must file Form 1041-T, Allocation of Estimated Tax Payments to Beneficiaries, in the time and manner

specified in the Instructions to Form 1041-T with the following modifications. At the top of the Form 1041-T, the following statement should be written, "FILED PURSUANT TO NOTICE 2001-25." Each reference in the Form 1041-T to beneficiary is deemed to refer to the deemed owner of the ESBT solely for purposes of this notice and the Form 1041-T should be completed accordingly. The trust's estimated tax payments included on Form 1041-T will be treated as a payment of estimated tax made by the deemed owner of the ESBT on January 15, 2001.

If the deemed owner of the ESBT is required to file Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts, the deemed owner may use Schedule AI, Annualized Income Installment Method. For this purpose, the deemed owner may take into account, as of the last day of the deemed owner's 2000 taxable year, all S corporation items allocable to the grantor portion of the ESBT.

EFFECTIVE DATE

This notice applies only for taxable years of ESBTs and of the deemed owners of those ESBTs ending on December 29, 30, or 31, 2000.

DRAFTING INFORMATION

The principal author of this notice is James A. Quinn of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Mr. Quinn on (202) 622-3060 (not a toll free call).