Qualified Funeral Trusts

Notice 98–66

PURPOSE

Section 6013(b) of the Internal Revenue Service Restructuring and Reform Act of 1998 (1998 Act), Pub. L. No. 105–206, 112 Stat. 685, amended the Qualified Funeral Trust (QFT) provisions of § 685 of the Internal Revenue Code: (1) to allow pre-need funeral trusts to continue to qualify as QFTs for a 60-day period beginning on the date of death of the grantor of the trust; and (2) to extend the Secretary's authority to prescribe rules for simplified reporting of QFTs that terminate during the taxable year. This notice provides guidance on the 1998 Act amendments to § 685. The amendments are effective for taxable years ending after August 5, 1997.

BACKGROUND

A "pre-need funeral trust" is an arrangement in which funeral or cemetery merchandise or services are purchased before the beneficiary's death. The purchaser enters into a contract with the seller whereby the purchaser selects, and pays for, the desired merchandise or services. Upon the death of the beneficiary, the seller provides the selected merchandise or services. Most states have laws or regulations that govern pre-need funerals trusts. These laws and regulations protect the beneficiary and provide for the investment of the money transferred to the seller. Usually, the seller is required to deposit a percentage of the money received into a pre-need funeral trust to be invested and held by the trust for the beneficiary until the funeral or cemetery merchandise or services are provided. The terms of the trust arrangements vary from seller to seller and the provisions governing pre-need funeral trusts vary from state to state.

In Rev. Rul. 87–127, 1987–2 C.B. 156, the Service addresses the taxation of pre-need funeral trusts in four situations. The ruling concludes that in all four situations the trust is a grantor trust and the purchaser of the trust is treated as the owner of the trust for federal tax purposes. The ruling further concludes that any payment received by the seller from the trust is a payment for merchandise or services and is includible under § 61 in the seller's gross income in the year received or properly accrued, depending on the seller's method of accounting.

The Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788, created the QFT provisions. Section 685 permits the trustees of certain pre-need funeral trusts to elect QFT status on behalf of the trusts. If a valid QFT election is made and the trust otherwise qualifies as a QFT under § 685, the trustee is liable for the tax on the taxable income of the trust. The amount of tax is determined in accordance with the income tax rate schedule generally applicable to trusts and estates. A QFT election may be made for an eligible trust for any taxable year ending after August 5, 1997.

In Notice 98–6, 1998–3 I.R.B. 52, the Service provided guidance on QFT eligibility requirements, election procedures, and simplified reporting requirements. The notice recognizes that pre-need trusts for cemetery merchandise and services, like pre-need trusts for funeral merchandise and services, may be treated as QFTs if they meet the requirements of § 685. The trustees of QFTs are required to file a trust return on behalf of the QFT. Form 1041–QFT, U.S. Income Tax Return for Qualified Funeral Trusts, is used to file the return and to make the QFT election. A trustee responsible for multiple QFTs may report the income for all of the QFTs on one composite Form 1041–QFT. A QFT election, once made, cannot be revoked without the consent of the Commissioner of Internal Revenue.

LOSS OF GRANTOR TRUST STATUS

One of the necessary qualifications for a QFT is that it would be treated, but for the QFT election, as a grantor trust for federal income tax purposes. Section 685(b)(6). Prior to the 1998 Act amendment, a trust would have lost its QFT status upon the death of the grantor because it would no longer have been a grantor trust. However, because actual distribution of the trust assets to the seller of the merchandise or services usually does not occur immediately upon the death of the decedent, the 1998 Act provides that a QFT retains its QFT status for the period of time between the decedent's death and the actual distribution of the trust assets to the seller, but not to exceed a 60-day period beginning on the date of the decedent's death. Any income earned by the QFT during this period must be reported by the trustee on the Form 1041–QFT.

SHORT YEAR QFTS

Section 685(f), as originally enacted, provided that the Secretary may prescribe rules for simplified reporting of all QFTs having a single trustee. The 1998 Act amendment to § 685(f) extends the Secretary's authority to prescribe rules for simplified reporting of QFTs terminated during the taxable year (for example, upon the beneficiary's death).

As a general rule, § 6072(a) provides that trust returns must be filed by the 15th day of the fourth month following the close of the taxable year. QFTs are required to adopt a calendar year. Therefore, QFTs generally are required to file an income tax return by April 15th of the year following the close of the calendar year. Under § 443, a trust that is in existence during only part of a year is required to file a return for that short period. QFTs that terminate during the year, therefore, would be required to file a return by the 15th day of the fourth month following the close of the short taxable year. For example, if the beneficiary of a QFT died on March 3rd and all the trust assets were distributed prior to the end of March, the trustee would be required to file the tax return by July 15th.

The Service recognizes that a trustee of multiple QFTs often has many QFTs that terminate during the calendar year. To simplify the reporting requirements for these trustees, a single, composite Form 1041-QFT may be filed for all QFTs managed by the same trustee, including short period QFTs. Therefore, a trustee of multiple QFTs is not required to file a separate tax return for any QFT that terminates during the year. The trustee of multiple QFTs has until April 15th of the year following the close of the calendar year to file a composite Form 1041–QFT, even when the return includes QFTs that terminate during the calendar year.

REQUESTS FOR COMMENTS

The Treasury and the Service invite comments from the public on issues that may arise in implementing the amendments to § 685. Send written comments to the following address:

Internal Revenue Service
CC:DOM:CORP (NT 98-66;
CC:DOM:P&SI:1)
P.O. Box 7604, Ben Franklin Station
Washington, D.C. 20044

Alternatively, send written comments electronically via the Internet to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. Please identify the comments as relating to this notice.

DRAFTING INFORMATION

The principal author of this notice is Shannon Cohen of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Shannon Cohen on (202) 622-3050 (not a toll-free call).