

2004

Beneficiary's Share of Income, Deductions, Credits, etc.

K-1 (541)

For calendar year 2004 or fiscal year beginning month ___ day ___ year 2004, and ending month ___ day ___ year ___
Complete a separate Schedule K-1 (541) for each beneficiary.

Name of estate or trust

Beneficiary's social security number, California corporation number, or FEIN Estate's or trust's FEIN

Beneficiary's name, address, and ZIP Code Fiduciary's name, address, and ZIP Code

- A Beneficiary's percentage of distribution at year end
B Check here only if this is: (1) A final Schedule K-1 (541) (2) An amended Schedule K-1 (541)
C What type of entity is this beneficiary? (1) Individual (2) Estate/Trust (3) Qualified Exempt Organization (4) Other
D Is this beneficiary a nonresident of California?
E Is the fiduciary a nonresident of California?

Caution: Refer to the instructions for Schedule K-1 (541) before entering information from this schedule on your California return.

Table with 5 columns: (a) Allocable share item, (b) Amount from federal Schedule K-1 (1041), (c) California Adjustments, (d) Total amounts using California law, (e) California source amounts and credits. Rows include Interest, Dividends, Net capital gain or (loss), Annuities, royalties, and other non-passive income, Trade or business, rental real estate, and other passive income, Income for alternative minimum tax purposes, Adjustments and tax preference items, Deductions in the final year of estate or trust, and Other (itemize).

2004 Instructions for Schedule K-1 (541)

Beneficiary's Share of Income, Deductions, Credits, etc.

What's New

For taxable years beginning on or after January 1, 2004, California reinstated the Net Operating Loss (NOL) carryover deductions. For more information, see form FTB 3805V, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations – Individuals, Estates, and Trusts.

If you have been involved in a potentially abusive tax shelter you may have a disclosure, registration, and list maintenance requirement. The Franchise Tax Board (FTB) may impose several new and enhanced penalties if you fail to file federal Forms 8886, 8264, 8271 or any required information. For more information, see Registration and Reporting Requirements under Abusive Tax Shelters on our Website at www.ftb.ca.gov.

A Purpose

The estate or trust uses Schedule K-1 (541) to report its beneficiary's share of the income, deductions, credits, etc. The estate or trust files copies of the Schedules K-1 (541) with the Form 541, California Fiduciary Income Tax Return.

Internet Access. You can download, view, and print California tax forms and publications from our Website at www.ftb.ca.gov.

B Who Must File

The fiduciary of the estate or trust (or one of the joint fiduciaries) must file a Schedule K-1 (541) for each beneficiary. A copy of each beneficiary's Schedule K-1 (541) must be attached to Form 541 filed with the FTB. The fiduciary also must give each beneficiary a copy of his or her respective Schedule K-1 (541) and a copy of the Beneficiary's Instructions for Schedule K-1 (541) or other prepared specific instructions. One copy of each Schedule K-1 (541) must be retained for the fiduciary's records.

C Penalty

The estate or trust will be charged a \$50 penalty for each failure to provide a copy of each beneficiary's Schedule K-1 (541), unless reasonable cause is established for not providing it, Revenue and Taxation Code (R&TC) Section 19183.

D Substitute Forms

If the estate or trust does not use an official FTB Schedule K-1 (541) or a software program with an FTB-approved Schedule K-1 (541), it must get approval from the FTB to use a substitute Schedule K-1 (541). Get FTB Pub. 1098, Guidelines for the Development and Use of Substitute, Scannable, and Reproduced Tax Forms, for more information.

E Taxable Year

Beneficiary's taxable year. The beneficiary's income from the estate or trust must be included in the beneficiary's return for the

taxable year in which the estate's or trust's taxable year ends.

Prior Year. Do not include in the beneficiary's income any amounts deducted on Form 541 for an earlier year that were credited or required to be distributed in that earlier year.

F Beneficiary's Income

If no special computations are required, use the following instructions to compute the beneficiary's income from the estate or trust.

California reporting requirements are the same as federal for:

- Income;
- Character of income;
- Allocation of deductions;
- Allocation of credits; and
- Gifts and bequests.

However, income of nonresidents from bank accounts, stocks, bonds, notes, and other intangible personal property is not income from sources in California unless 1) the property has acquired a business situs in California or 2) orders with brokers have been placed so regularly as to constitute "doing business" (R&TC Section 17952). Include in column (e) only income from intangible property that is income from sources within California.

Attach a separate schedule to each beneficiary's Schedule K-1 (541) showing intangible income, such as interest, dividends, capital gains from the sale of stocks, bonds, etc., whose source is dependent upon the residence or commercial domicile of the beneficiary.

For nonresidents, income from a trade or business conducted within and outside California is apportioned or allocated to California in accordance with Cal. Code Regs., tit. 18 section 17951-4(c).

G Passive Activities

The limitations on passive activity losses and credits under Internal Revenue Code (IRC) Section 469 apply to estates and trusts. Estates and trusts that distribute income to beneficiaries are allowed to allocate depreciation, depletion, and amortization deductions to beneficiaries. These deductions are called "directly allocable deductions."

If items of income (loss), deduction, or credit from more than one activity are reported on Schedule K-1 (541), the fiduciary must attach a statement to Schedule K-1 (541) for each passive activity.

H Nonresident Beneficiaries

If the beneficiary of an estate or trust was a nonresident of California for the estate's or trust's entire taxable year, California will only tax the beneficiary on income that is derived from California sources. If the beneficiary of an estate or trust is a resident of California for only part of the estate's or trust's taxable year, California will tax the beneficiary's share of the estate's or trust's income or loss in accordance with FTB Publication 1100 and Legal Ruling 2003-1.

Where an estate or trust derives income from both within and outside California, it is necessary for the fiduciary to determine what portion of the beneficiary's share of income of the estate or trust is from within and outside California. The amounts derived from or attributable to income from sources within and outside California are to be properly allocated and reported on the Schedule K-1 (541).

Payments to nonresidents having a business or taxable situs in California are subject to withholding of taxes. For more information, get the Instructions for Form 592, Form 592-A, and Form 592-B.

General Summary of Treatment for Sourcing Specific Nonbusiness Income Items

For California tax purposes:

- Compensation for personal services has a source where the services are performed.
- Interest and dividends generally have a source at the taxpayer's state of residence.
- Gains and losses from the sale or exchange of real and tangible personal property have a source where the property is located.
- Income from intangible personal property generally has a source at the taxpayer's state of residence. Rents and royalties have a source where the property is located.
- Pensions have a source where the services were performed. However, California does not impose a tax on qualified retirement income or pensions received by nonresidents on or after January 1, 1996.

Generally, income from a business, trade, or profession is sourced as follows:

- If the operations are conducted wholly within California, the income has a California source.
- If the operations within California are so separate and distinct from the operations outside of California that taxable income can be separately accounted for, only the income from within California must be included in California source income.
- If the trade or business carried on within California is an integral part of a unitary business carried on outside of California, the entire net income must be reported and apportioned or allocated in accordance with the provisions of the Uniform Division of Income for Tax Purposes Act as contained in R&TC Sections 25120 through 25139.

Partnership, limited liability company, and S corporation income (loss), is apportioned or allocated in the same manner as any other business. If the estate or trust is a partner, member, or shareholder in a business entity, income sourced to California is generally included in column (e) of the Schedules K-1 (565, 568, or 100S). For more detailed information, review Cal. Code Regs., tit. 18 section 17951.4 and related tax codes.

See Cal. Code Regs., tit. 18 sections 17951-1(c), 17951-2, and 17953 regarding taxability of distributions to nonresident beneficiaries.

If California source income is being distributed to a nonresident beneficiary, see instructions regarding withholding at source in General Information P, Miscellaneous Items, of the Form 541 instructions.

Note: If the beneficiary of an estate or trust was a resident of California for the estate's or trust's entire taxable year, the beneficiary's share of the estate's or trust's income or loss for the taxable year is taxable to California.

Specific Line Instructions

Please round cents to the nearest whole dollar.

The estate or trust is required to request and provide a proper identification number for each beneficiary, see R&TC Section 18624. Enter the beneficiary's number on the respective Schedule K-1 (541) when the estate or trust files Form 541, California Fiduciary Income Tax Return.

Individuals and business beneficiaries are responsible for giving the estate or trust their social security number, California corporation number, Secretary of State file number, or federal employer identification number (FEIN) upon request.

The estate or trust may use federal Form W-9, Request for Taxpayer Identification Number and Certification, to request the beneficiary's identifying number.

Columns (b), (c), (d), and (e)

In **column (b)**, the amounts entered are from your federal Schedule K-1 (1041).

In **column (c)**, the amounts entered are the adjustments resulting from differences between California and federal law for each specific line item.

In **column (d)**, the amounts entered are the result of combining column (b) and column (c).

In **column (e)**, the amounts entered are used to report California source income and credits.

Line 1 and Line 2

Enter in column (b) the amounts from Schedule K-1 (1041), and in column (c) any adjustments resulting from differences between California and federal law for each specific line item.

Line 3 – Enter the combined amount from federal Schedule K-1 (1041), line 3, and line 4a.

Note: Gains or losses from the complete or partial disposition of a rental real estate or trade or business activity that is a passive activity must be shown on an attachment to Schedule K-1 (541).

Line 4 – Enter on line 4a the beneficiary's share of annuities, royalties, or any other income (before directly allocable deductions) that is not subject to any passive activity loss limitation rules at the beneficiary level. Enter on line b, line c, and line d the beneficiary's share of the directly allocable deductions for depreciation, depletion, or amortization.

Line 5 – Enter on line 5a the beneficiary's share of trade or business, rental real estate, and other passive income (before directly

allocable deductions) that is subject to any passive activity loss limitation rules at the beneficiary's level. Enter on line b, line c, and line d the beneficiary's share of the directly allocable deductions for depreciation, depletion, or amortization.

Line 6 – An estate or trust cannot pass through the alternative minimum taxable income (AMTI) exclusion to the beneficiary. The Schedule P (541), Alternative Minimum Tax and Credit Limitations – Fiduciaries, for the estate or trust must be recalculated leaving line 7b blank. This will eliminate the effect of the AMTI exclusion but allow other items of adjustment or tax preference to be passed through to the beneficiary. The recalculated amount on Schedule P (541), line 10, must be entered on Schedule K-1 (541), line 6.

Line 9a through Line 9d

Enter the amounts from Schedule P (541). Get the instructions for federal Schedule K-1 (1041) for more information.

Line 10a through Line 10d

If this is the final return, enter on line 10 the beneficiary's share of any:

- Excess deductions on termination (follow the instructions for federal Form 1041);
- Capital loss carryover; or
- Unused net operating loss (NOL) carryover for both regular and alternative minimum tax, if the NOL carryover would be allowed to the estate or trust in a later year but for termination.

Note: No deduction is allowed for estate taxes.

Net Operating Loss (NOL)

For taxable years beginning in 2002 and 2003, California suspended the NOL carryover deduction. Taxpayers may continue to compute and carryover an NOL during the suspension period. However, the deduction for disaster losses is not affected by the NOL suspension rules.

For taxable years beginning on or after January 1, 2004, California reinstated the NOL carryover deductions. The carryover periods for an NOL incurred in years:

- beginning before January 1, 2002, have been extended for two years.
- beginning on or after January 1, 2002, and before January 1, 2003, have been extended for one year.

For taxable years beginning on or after January 1, 2004, 100% of the NOL may be carried forward. For more information, see form FTB 3805V, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations — Individuals, Estates, and Trusts.

For taxable years beginning on or after January 1, 2002, the NOL carryover computation for the California taxable income of a nonresident or part-year resident **is no longer limited** by the amount of NOL from all sources.

Line 11a through Line 11e

Enter the beneficiary's share of each item, trust payments, tax-exempt interest, or credits on Schedule K-1 (541). Attach a separate sheet for each item reported on line 11 showing the computation. Items that must be reported on this line include the allocable share, if any, of items listed on line 11a through line 11d.

Line 11a — Enter the beneficiary's share of estimated payment credited.

Note: Form 541-T is required to be submitted in order for the beneficiary to receive credit for the payments.

Line 11b – Enter tax-exempt interest received by the estate or trust (including exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company).

Line 11c – Enter taxes paid to other states reported on Schedule S, Other State Tax Credit.

Note: Attach a copy of the return filed with the other state, evidence of payment, and a copy of Schedule S to verify the amount of tax paid.

Line 11d – Enter on an attached schedule each beneficiary's allocable share of any credit or credit information that is related to a trade or business activity.

Line 11e – Enter any other item that is not included above such as:

- Gross farming and fishing income; or
- Investment income, see IRC Section 163(d).

The estate or trust may need to report supplemental information that is not specifically requested on the Schedule K-1 (541) separately to each beneficiary.

If the estate or trust is claiming tax benefits from an Enterprise Zone (EZ), Los Angeles Revitalization Zone (LARZ), Local Agency Military Base Recovery Area (LAMBRA), Manufacturing Enhancement Area (MEA), or Targeted Tax Area (TTA), it should give the beneficiaries their distributive share of the business income and business capital gain or loss apportioned to the EZ, LARZ, LAMBRA, MEA, or TTA on this line.