

The references to line numbers and form numbers on federal income tax forms were correct at the time of printing. If they have changed and you are unable to determine the proper line to use, please contact the Department of Revenue. These instructions are to be used as a guide in the preparation of a North Carolina estates and trusts income tax return and are not intended to cover all provisions of the law.

GENERAL INFORMATION

Who must file Form D-407. A fiduciary must file North Carolina Form D-407 for the estate or trust if the fiduciary is required to file a federal income tax return for estates and trusts and (1) the estate or trust derives income from North Carolina sources or (2) the estate or trust derives any income which is for the benefit of a resident of North Carolina. **Exception:** With respect to grantor trust returns, the Department of Revenue has access to the federal information contained in the federal grantor trust returns. Therefore, a State grantor trust return is not required to be filed when the entire trust is treated as a grantor trust for federal tax purposes.

Other returns to be filed by fiduciaries:

(1) Returns for decedents. A personal representative must file an individual income tax return, Form D-400, for the last taxable year of the decedent if the decedent had income that was sufficient to require the filing of an individual income tax return.

(2) Returns for other individuals. A fiduciary, including the guardian of a minor (who has not filed a return) and the guardian of a mentally incompetent individual who has charge of the income of the individual, must file a return on Form D-400 if a return is required for such an individual.

Period to be covered by the return. Returns shall be filed for the calendar year 2020 or fiscal year beginning in 2020. If the return is filed for other than a calendar year, fill in the beginning and ending dates of the taxable year in the boxes at the top of page 1.

Time and place for filing. Returns must be filed on or before the 15th of April for an estate or trust filing on the calendar year basis, and on or before the 15th day of the fourth month following the close of the fiscal year for an estate or trust filing on a fiscal year basis. If the estate or trust chooses not to e-file the estate and trust return, mail the return, any payment due, and Form D-407V to the following address: North Carolina Department of Revenue, P. O. Box 25000, Raleigh, North Carolina 27640-0640. For information on e-file, visit the Department's website.

Extensions. An estate or trust that is granted an automatic extension to file a federal income tax return will be granted an automatic extension to file the corresponding North Carolina income tax return. The estate or trust must certify on the North Carolina tax return that it was granted an automatic federal extension. If it is not granted an automatic federal extension, the estate or trust must file Form D-410P, Application for Extension for Filing Partnership, Estate, or Trust Tax Return, by the original due date of the return in order to receive an extension for North Carolina purposes.

The fiduciary is not required to send a payment of the tax it estimates as due to receive the extension; however, it will benefit the estate or trust to pay as much as it can with the extension request.

A 10 percent late payment penalty will apply on the remaining balance due if the tax paid by the original due date of the return is less than 90

percent of the total tax due. If the 90 percent rule is met, any remaining balance due must be paid with the estate or trust return on or before the expiration of the extension period to avoid the late payment penalty. A fiduciary may file the return at any time within the extension period but it must be filed on or before the end of the extension period to avoid the late filing penalty.

Signature. The fiduciary or authorized representative must sign Form D-407. The return must also be signed by the person or in the name of the firm or corporation preparing the fiduciary's return for compensation. The daytime telephone number of the fiduciary should be shown so the fiduciary can be reached if additional information is needed to process the return. For information regarding paid preparer authorization, see page 17 of the Individual Income Tax Instructions (Form D-401).

When and to whom the tax must be paid. The tax of an estate or trust must be paid in full when the return is filed. The tax may be paid by check or money order payable in U.S. dollars to the North Carolina Department of Revenue. **Important:** The Department will not accept a check or money order unless it is drawn on a U.S. (domestic) bank and the funds are payable in U.S. dollars.

Penalties and interest. For failure to file a timely estate or trust return, the penalty is 5 percent of the net tax due per month with a 25 percent maximum. Returns filed after April 15 without a valid extension are also subject to a late payment penalty of 10 percent of the unpaid tax. In addition, penalties are provided for fraud, for willful failure to file on time, and for willful attempt to evade or defeat the tax. Taxes also bear interest from the due date until the date paid.

Copy of governing instrument. A copy of the decedent's will or the trust instrument is not required unless the Department requests it. If the Department requests a copy, file the copy (including any amendments) with the following:

- (1) A signed statement under affirmation that the copy of the will is true and complete.
- (2) A statement listing the provisions of the will or the trust instrument that divide the income among the estate or trust and the beneficiaries.

Specific Instructions for Form NC K-1. Schedule NC K-1 for Form D-407 is used by an estate or trust to report each beneficiary's share of income, adjustments, tax credits, etc. Prepare and give a Schedule NC K-1 to each person who was a beneficiary of the estate or trust at any time during the year. Schedule NC K-1 must be provided to each beneficiary on or before the day on which the estate or trust return is required to be filed.

N. C. Education Endowment Fund Contribution. An estate or trust may elect to contribute to the N.C. Education Endowment Fund by directly contributing to the Fund or by designating some of all of its overpayment to the Fund. To make a contribution, complete form NC-EDU and enclose the form and applicable payment with the return. Form NC-EDU is available online at www.ncdor.gov. To designate your overpayment, see the specific instructions for Line 19.

If the estate or trust is not due a refund, it may still contribute to this Fund by mailing a donation directly to the North Carolina Department of Public Instruction. To make a donation, mail your donation to: North Carolina Department of Public Instruction, Cash Collections, 6336 Mail Service Center, Raleigh, North Carolina 27699-6336. Checks should be made payable to the North Carolina Department of Public Instruction and should indicate it is a contribution for the North Carolina Education Endowment Fund.

SPECIFIC INSTRUCTIONS

Line 1. Enter on Line 1 the federal taxable income from Federal Form 1041.

Line 2. Determine the amount to enter on Line 2 by completing Schedule A, Lines 1 through 5, and allocating the additions between the fiduciary and the beneficiaries in Schedule B, Line 4. Enter on Line 2 the amount from Schedule B, Fiduciary Column, Line 4.

Line 4. Determine the amount to enter on Line 4 by completing Schedule A, Lines 6 through 12, and allocating the deductions between the fiduciary and the beneficiaries in Schedule B, Line 5. Enter on Line 4 the amount from Schedule B, Fiduciary Column, Line 5.

Line 6. If none of the federal taxable income, as adjusted, is from dividends, interest, gains, losses, other intangibles, or is business income from sources outside North Carolina for the benefit of a nonresident beneficiary, the total income of the estate or trust is taxable to the fiduciary and you should enter zero on Line 6. If there are nonresident beneficiaries and Line 5 includes any income from interest, dividends, gains, losses, other intangible property, or business income from sources outside North Carolina for the benefit of a nonresident beneficiary, enter the amount of such income for the benefit of nonresident beneficiaries on Line 6. The determination of the amount of federal taxable income (as adjusted) which is from intangible property or is business income from sources outside North Carolina for the benefit of a nonresident beneficiary is based on the income beneficiary's state of residence on the last day of the taxable year of the estate or trust.

Important. On June 21, 2019, the United States Supreme Court ("Court") held that the presence of "in-state beneficiaries alone does not empower a state to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it." *North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust ("Kaestner")*, 139 S. Ct. 2213, 2221 (2019). By contrast, the Court stated that taxation of trust income based on distributions of trust income to an in-state resident, a trustee's in-state residence, or in-state trust administration does not violate the Constitution. *Id.* at 2220.

Trusts with connections to the State should carefully analyze those connections to determine if the connections are sufficient for the State to tax the entity's undistributed taxable income under the Due Process Clause. If Line 5 includes undistributed income for the benefit of a resident beneficiary that meets the facts and circumstances of *Kaestner* such that the income is not taxable to North Carolina, enter the amount of such income on Line 6.

Line 9. Complete Form D-407TC, Estates and Trusts Tax Credit Summary, to determine the fiduciary's share of any tax credits. Enter on Line 9 the amount from Form D-407TC, Line 13.

Line 10. If Form D-410P was filed to request an extension of time to file Form D-407, include any tax paid with the extension on Line 10.

Line 11. No estimated tax is required of a fiduciary; however, if the fiduciary makes any prepayments of tax, include the prepayment on Line 11. If filing an amended return, include on this line any amount paid with the original return.

Line 12. If tax was paid by a partnership or S corporation on behalf of the estate or trust, enter the amount paid and include with the return a copy of the information furnished by the partnership or S corporation to verify the payment. Also enter any North Carolina tax withheld that was reported on Form 1099R or other 1099 and include a copy of the form.

Line 15. Add Lines 15a and 15b and enter the total on Line 15c. For more information, see "Penalties and Interest" in the General Information section.

Line 16. Pay this Amount. Add Lines 14 and 15c and enter the total on Line 16. The total tax, penalties, and interest due must be paid by the fiduciary responsible for administering the estate or trust.

Line 18. Contribution to the N. C. Nongame and Endangered Wildlife Fund. An estate or trust may elect to contribute part or all of its overpayment to the North Carolina Nongame and Endangered Wildlife Fund. Tax deductible contributions are essential to match private and federal grants to pay for conservation projects from sea turtles to songbirds, from native fish to bats. Conserving these species and their habitat is made possible by contributions. Donations provide most of the funds for conservation of our endangered species and native backyard wildlife. If the estate or trust wishes to contribute to the Fund, enter the amount of the contribution on Line 18. **The election to contribute to the Fund cannot be changed after the return is filed.** If the estate or trust is not due a refund, it may still contribute to this Fund by mailing your donation directly to the North Carolina Wildlife Resources Commission, 1702 Mail Service Center, Raleigh, North Carolina 27699-1700. Checks should be made payable to the Nongame & Endangered Wildlife Fund. For more information about the Fund, check out www.ncwildlife.org/GiveDonate.

Line 19. If the taxpayer wishes to contribute all or a part of its refund to the N.C. Education Endowment Fund, enter the amount of the contribution on Line 19. **The election to contribute to the Fund cannot be changed after the return is filed.**

Line 21. Enter the amount of overpayment to be refunded on Line 21. The amount to be refunded cannot exceed Line 17 minus the total of Lines 18 and 19.

Schedule A - North Carolina Fiduciary Adjustments

Schedule A is provided for the computation of the North Carolina fiduciary adjustments. Generally, estates and trusts are subject to the same additions and deductions allowed to individuals. *(For a more detailed explanation of any applicable adjustments, see Form D-401, North Carolina Individual Income Tax Instructions, available from the Department's website.)*

Additions to federal taxable income. If you have income items that are not included in federal taxable income but are taxable to North Carolina, complete Lines 1 through 5.

Line 1. Enter on Line 1 any interest received from bonds or obligations of a state or its political subdivisions other than North Carolina if not included in income.

Line 2. Enter on Line 2 any state, local, or foreign income taxes deducted on the federal return.

Line 3. Enter on Line 3 any adjustments for bonus depreciation.

Line 4. Enter on Line 4 any other required additions.

Line 5. Enter the total of Lines 1, 2, 3, and 4 on Line 5. The total additions should be apportioned between the beneficiaries and the fiduciary on Schedule B, Line 4.

Deductions from federal taxable income. If you have income items that are included in federal taxable income but are not taxable to North Carolina, complete Lines 6 through 12.

Line 6. Enter any interest income which was received from obligations of the United States or United States' possessions.

Line 7. Enter the taxable portion of any Social Security or Railroad Retirement benefits included in income.

Line 8. Enter on Line 8 retirement benefits received from vested N. C. State government, N. C. local government, or federal government retirees.

As a result of the North Carolina Supreme Court's decision in **Bailey v. State of North Carolina**, North Carolina may not tax certain retirement benefits received by retirees (and their beneficiaries and estates) of the State of North Carolina and its local governments or by United States government retirees (and their beneficiaries and estates), including military retirees. The exclusion applies to retirement benefits received from certain defined benefit plans, such as the North Carolina Teachers' and State Employees' Retirement System, the North Carolina Local Governmental Employees' Retirement System, the North Carolina Consolidated Judicial Retirement System, the Federal Employees' Retirement System, or the United States Civil Service Retirement System, if the retiree had five or more years of creditable service as of August 12, 1989. The exclusion also applies to retirement benefits received from the State's §401(k) and §457 plans if the retiree had contributed or contracted to contribute to the plan prior to August 12, 1989. **This exclusion does not apply to local government §457 plans or to §403(b) annuity plans.** Benefits from other State, local, and federal retirement plans may or may not be excluded depending on rulings in the **Bailey case**. The exclusion does not apply to retirement benefits paid to former teachers and state employees of other states and their political subdivisions. An estate entitled to exclude retirement benefits from North Carolina income tax should claim a deduction on Line 8 for the amount of excludable retirement benefits included in federal taxable income. A copy of Form 1099-R received from the payer must be attached to the return to support the deduction.

Line 9. Enter any state, local, or foreign income tax refund that was included in income.

Line 10. Enter 20 percent of the bonus depreciation added back on the 2015, 2016, 2017, 2018, and 2019 State returns.

Line 11. Enter on Line 11 any other allowable deductions.

Line 12. Enter the total of Line 6, 7, 8, 9, 10f, and 11 on Line 12. The total deductions on Line 12 should be apportioned between the beneficiaries and the fiduciary on Schedule B, Line 5.

Schedule B - Apportionment of Income and Adjustments

In taxing estates and trusts, all income is taxable to the fiduciary or to the beneficiaries. The conduit rule for taxing estates and trusts is applicable for North Carolina income tax purposes. Under the conduit rules regardless of who is taxed, the income retains its same character as when received by the estate or trust. The additions and deductions to federal taxable income of an estate or trust must be apportioned between the estate or trust and the beneficiaries based on the distributions of income made during the taxable year (**Note:** The addition for bonus depreciation shall be apportioned between the fiduciary and beneficiaries. The addition reported by the fiduciary will be deducted on the fiduciary's return in the next five years and is not apportioned to any of the beneficiaries.). If the trust instrument or will that created the estate or trust does not provide for the distribution of certain classes of income to different beneficiaries, the apportionment of additions and deductions to the beneficiaries is determined on the basis that each beneficiary's share of the estate's or trust's "total income," the sum of lines 1 through 8 on the beneficiary's Schedule K-1, Federal Form 1041, relates to "adjusted total income" from Line 17 of Federal Form 1041. If the trust instrument or will specifically provides for the distribution of certain classes of income to different beneficiaries, any addition or deduction directly attributable to a particular class of income must be apportioned to the beneficiaries to which that class of income is distributed. In apportioning the adjustments, the total income on Federal Schedule K-1 must be adjusted for distributions to the beneficiaries that are not reflected in the total income. The adjusted total income (Line 17 of Federal Form 1041) must be adjusted (1) to exclude classes of income that are not part of the distribution to the beneficiary; (2) to include classes of income that are a part of the distribution to the beneficiary but are not included on Line 17; and (3) by any deduction treated differently for State and federal tax purposes that adjusts federal taxable income (see additions and deductions, Line 1 through 12 of Schedule A). The fiduciary may elect to apportion the federal deduction

for State income tax to the estate or trust except in cases where the beneficiary's total distribution from the estate or trust has not been included in his federal taxable income because it exceeded the estate's or trust's federal distributable net income. In such cases, the addition for State income tax must be apportioned to the beneficiary to the extent his distribution exceeds the amount included in federal taxable income because of the State income tax deduction. After apportioning the additions and deductions to the beneficiaries, the balance is apportioned to the fiduciary. Line 3, Net N.C. Source Income, should reflect the sum of Lines 6 and 7, minus Line 8 from D-407 NC K-1.

Enter the full name and identifying number of each beneficiary and determine the additions and deductions to be allowed to each beneficiary and to the fiduciary. Each beneficiary should be furnished a Schedule NC K-1 showing the applicable additions, deductions, tax credits, etc., to be reported on the beneficiary's North Carolina income tax return. A nonresident individual, in calculating the percentage of taxable income subject to North Carolina tax on the individual income tax return, must adjust his share of the income from North Carolina sources only by the additions and deductions attributable to the North Carolina income. The fiduciary's portion of the additions and deductions should be reported on Lines 2 and 4, respectively, on Page 1 of Form D-407.

Form D-407TC - Estates and Trusts Tax Credit Summary

Complete Form D-407TC, Estates and Trusts Tax Credit Summary, if the estate or trust claims any tax credits. All tax credits allowed to individuals are allowed to estates and trusts except the tax credit for income tax paid to other states or countries by individuals under N.C. Gen. Stat. § 105-153.9.

Form D-407TC and, if applicable, Form NC-478 and Form NC-Rehab must be filed for any taxable year in which the estate or trust is eligible to claim a tax credit or an installment of a tax credit against the tax liability. This requirement applies even if the estate or trust tax liability is not large enough to benefit from the credit. **Important:** If the estate or trust claims a tax credit on Form D-407, Line 9, Form D-407TC must be attached to Form D-407. If the form is not attached, the Department may be unable to process your return. Failure to substantiate a tax credit may result in the disallowance of that credit.

Credits for income taxes paid to other states or countries by estates and trusts. The tax credit for income taxes paid to another state or country under N.C. Gen. Stat. § 105-160.4 must be allocated between the fiduciary and the beneficiaries. To determine the tax credit allowable to the fiduciary, Part 5 must be completed. However, before Part 5 can be completed, gross income (from federal Form 1041, Line 9) on which such tax was paid must be allocated between the fiduciary and the beneficiaries.

The fiduciary's share and each beneficiary's share of the gross income on which tax has been paid to another state or country and the amount of tax paid on the income is determined by the governing instrument and such amount should be entered on Lines 3 and 4 of the fiduciary and the beneficiary's columns in Part 5, Section A. After allocating to the beneficiaries, enter the fiduciary's share of gross income taxed in another state or country on Part 5, Section B, Line 1. Enter on Part 5, Section B, Line 2 the fiduciary's share of gross income from federal Form 1041, Line 9. Complete the remaining Lines in Part 5, Section B to determine the fiduciary's share of the tax credit.

Credits for rehabilitating historic structures. For information on Article 3D, 3H, and 3L, see Form D-401, North Carolina Individual Income Tax Instructions, available from the Department's website.

Sunset for tax credit subject to 50% of tax limit. Many of the tax credits subject to 50% of tax available are repealed or designated for sunset. Taxpayers who qualified for these tax credits may continue to take any remaining installments and carryforwards of those tax credits after the sunset date if the taxpayer continues to meet the statutory eligibility requirements for each particular tax credit. For more information, see each specific Article.