

Form **8960**

# Net Investment Income Tax— Individuals, Estates, and Trusts

OMB No. XXXX-XXXX

# 2013

Department of the Treasury  
Internal Revenue Service (99)

▶ Attach to Form 1040 or Form 1041.

▶ Information about Form 8960 and its separate instructions is at [www.irs.gov/form8960](http://www.irs.gov/form8960).

Attachment  
Sequence No. **72**

Name(s) shown on Form 1040 or Form 1041

Your social security number or EIN

**Part I Investment Income**     Section 6013(g) election (see instructions)     Regulations section 1.1411-10(g) election (see instructions)

<b>1</b>	Taxable interest (Form 1040, line 8a; or Form 1041, line 1)		<b>1</b>	
<b>2</b>	Ordinary dividends (Form 1040, line 9a; or Form 1041, line 2a)		<b>2</b>	
<b>3</b>	Annuities from nonqualified plans (see instructions)		<b>3</b>	
<b>4a</b>	Rental real estate, royalties, partnerships, S corporations, trusts, etc. (Form 1040, line 17; or Form 1041, line 5)	<b>4a</b>		
<b>b</b>	Adjustment for net income or loss derived in the ordinary course of a non-section 1411 trade or business (see instructions)	<b>4b</b>		
<b>c</b>	Combine lines 4a and 4b		<b>4c</b>	
<b>5a</b>	Net gain or loss from disposition of property from Form 1040, combine lines 13 and 14; or from Form 1041, combine lines 4 and 7	<b>5a</b>		
<b>b</b>	Net gain or loss from disposition of property that is not subject to net investment income tax (see instructions)	<b>5b</b>		
<b>c</b>	Adjustment from disposition of partnership interest or S corporation stock (see instructions)	<b>5c</b>		
<b>d</b>	Combine lines 5a through 5c. If zero or less, enter -0-		<b>5d</b>	
<b>6</b>	Traders in financial instruments or commodities add back net gain or loss (see instructions)		<b>6</b>	
<b>7</b>	Other modifications to investment income (see instructions)		<b>7</b>	
<b>8</b>	Total investment income. Add lines 1, 2, 3, 4c, 5d, 6, and 7		<b>8</b>	

**Part II Investment Expenses Allocable to Investment Income and Modifications**

<b>9a</b>	Investment interest expenses (see instructions)	<b>9a</b>		
<b>b</b>	State income tax (see instructions)	<b>9b</b>		
<b>c</b>	Miscellaneous investment expenses (see instructions)	<b>9c</b>		
<b>d</b>	Add lines 9a, 9b, and 9c		<b>9d</b>	
<b>10</b>	Additional modifications (see instructions)		<b>10</b>	
<b>11</b>	Total deductions and modifications. Add lines 9d and 10		<b>11</b>	

**Part III Tax Computation**

<b>12</b>	Net investment income. Subtract Part II, line 11 from Part I, line 8. Individuals complete lines 13–17. Estates and trusts complete lines 18a–21. If zero or less, enter -0-		<b>12</b>	
<b>Individuals:</b>				
<b>13</b>	Modified adjusted gross income (see instructions)	<b>13</b>		
<b>14</b>	Threshold based on filing status (see instructions)	<b>14</b>		
<b>15</b>	Subtract line 14 from line 13. If zero or less, enter -0-	<b>15</b>		
<b>16</b>	Enter the smaller of line 12 or line 15		<b>16</b>	
<b>17</b>	Net investment income tax for individuals. Multiply line 16 by 3.8% (.038). Enter here and on Form 1040, line 60		<b>17</b>	
<b>Estates and Trusts:</b>				
<b>18a</b>	Net investment income (line 12 above)	<b>18a</b>		
<b>b</b>	Deductions for distributions of net investment income and deductions under section 642(c) (see instructions)	<b>18b</b>		
<b>c</b>	Undistributed net investment income. Subtract line 18b from 18a (see instructions)	<b>18c</b>		
<b>19a</b>	Adjusted gross income (see instructions)	<b>19a</b>		
<b>b</b>	Highest tax bracket for estates and trusts for the year (see instructions)	<b>19b</b>		
<b>c</b>	Subtract line 19b from line 19a. If zero or less, enter -0-	<b>19c</b>		
<b>20</b>	Enter the smaller of line 18c or line 19c		<b>20</b>	
<b>21</b>	Net investment income tax for estates and trusts. Multiply line 20 by 3.8% (.038). Enter here and on Form 1041, Schedule G, line 4		<b>21</b>	



# Instructions for Form 8960

## Net Investment Income Tax— Individuals, Estates, and Trusts

Section references are to the Internal Revenue Code unless otherwise noted.

### General Instructions

#### What's New

**Future developments.** For the latest information about developments related to Form 8960 and its instructions, such as legislation enacted after they were published, go to [www.irs.gov/form8960](http://www.irs.gov/form8960).

#### Who Must File

Attach Form 8960 to your return if Form 8960, line 16 is greater than 0 (individuals) or line 20 is greater than 20 is greater than 0 (estates and trusts).

#### Purpose of Form

Use Form 8960 to figure the amount, in any, of your Net Investment Income Tax (NIIT).

#### Recordkeeping

**Individuals.** The NIIT applies to individual taxpayers who have net investment income and modified adjusted gross income in excess of the applicable threshold amount. The NIIT is 3.8 percent of the lesser of your (A) net investment income for the taxable year, or (B) the excess, if any, of your modified adjusted gross income for the taxable year over the applicable threshold amount.

The applicable threshold amount is based on your filing status:

- Married Filing Jointly or Qualifying Widower with Dependent Child is \$250,000
- Married Filing Separately is \$125,000
- Single or Head of Household is \$200,000

The NIIT does not apply to a nonresidential alien. If you are a U.S. citizen married to a nonresident alien, your filing status will be married filing separately for purposes of determining your threshold amount. In accordance with the rules for married taxpayers filing separate returns, the U.S. citizen or resident spouse must determine his or her own net investment income and modified adjusted gross income.

**Election to file jointly with nonresident spouse.** If you and your nonresident alien spouse elected to file a joint Federal

income tax return pursuant to an election under section 6013(g), you can also elect to be treated as making a section 6013(g) election for purpose of determining your NIIT. For purposes of calculating your NIIT, the effect of such election is to include your income combined with the income of your nonresident alien spouse in determining your net investment income and your modified adjusted gross income. If such an election is made, the applicable threshold amount would be that applicable to married filing a joint return (\$250,000). See Instructions for (insert appropriate reference) for how to make the election.

#### Estates and Trusts

The NIIT applies to estates and trusts that have undistributed Net Investment Income and adjusted gross income in excess of the threshold amount. The NIIT is the lesser of (A) the undistributed net investment income for such taxable year, or (B) the excess, if any, of your adjusted gross income (as defined in section 67(e)) over the applicable threshold amount.

The applicable threshold amount is the dollar amount at which the highest tax bracket in section 1(e) begins for the taxable year. See Form 1041 instructions for the highest tax bracket.

#### Exception for Certain Domestic Trusts

(1) A trust all of the unexpired interests in which are devoted to one or more of the purposes described in section 170(c)(2) (B); (2) A trust exempt from tax under section 501, and any other trust, fund, or account that is statutorily exempt from taxes imposed in subtitle A; (3) A trust, or a portion thereof, that is treated as a grantor trust under subpart E of part I of subchapter J of chapter 1; (4) A charitable remainder trust as described in section 664 - See Form 5227 for additional information. See IRC regulation section 1.1411-3(b) for a complete explanation of exceptions for certain trusts; (5) Business Trusts described in 301.7701-4(b) are excluded; (6) The general rule excludes certain state law trusts (for example common trust funds and designated settlement funds); (7) Charitable Remainder Trusts

#### Specific Trusts

The NIIT does apply to the following trusts: (1) Electing Small Business Trusts (ESBTs) [see IRC regulation 1.1411-3(c) (1)(ii) for the general rules of application and separate instructions for special computational rules for ESBTs]; (2) Pooled Income Funds; (3) Cemetery Perpetual Care Funds; (4) Qualified Funeral Trusts; (5) Certain Alaska Native Settlement Trusts.

#### Foreign Estates and Foreign Trusts

In general, the NIIT does not apply to foreign estates and foreign trusts that have little or no connection to the United States [for example, if none of the beneficiaries is a United States person]. However, the net investment income of a foreign estate or foreign trust should be subject to the NIIT to the extent that such income is earned or accumulated for the benefit of, or distributed to, United States persons.

#### Bankruptcy Estates of an Individual

A bankruptcy estate of an individual debtor(s) is treated as an individual for purposes of the NIIT. As such, regardless of the actual marital status of the debtor(s), the applicable threshold for purposes of determining the NIIT is the amount applicable for a married person filing separately.

#### Passive Activity

##### General Rules

Net Investment Income generally includes income and gain from passive activities. A passive activity for purposes of Net Investment Income has the same meaning as under section 459. A passive activity includes any trade or business in which you do not materially participate. A passive activity also includes any rental activity, regardless of whether the taxpayer materially participates (there are limited exceptions for rentals see discussion below).

For more details on passive activities, see the Instructions for Form 8582 and Publication 925.

## Trade or Business Activities

The definition of trade or business for Net Investment Income purposes is limited to a trade or business within the meaning of section 162. This is more restrictive than the definition of a trade or business for passive activity purposes. For example, for passive activity purposes, a trade or business includes any activity conducted in anticipation of the commencement of a trade or business and any activity involving research or experimentation. In some cases, income from activities that are not passive activities under section 469 will be included in Net Investment Income because the activity does not rise to the level of a trade or business within the meaning of section 162. The activity must be a trade or business within the meaning of section 162 and be non-passive before the income is excluded from the Net Investment Income Tax.

If you own an interest in a pass-through entity, the determination of whether the activity is engaged in a trade or business is made at the entity level.

## Material Participation

A trade or a business is a passive activity if you did not materially participate in the activity during the year. If you are an individual, you materially participate in your trade or business activity if you are involved in the operations of the activity on a regular, continuous, and substantial basis. You will be treated as materially participating in an activity if and only if you meet one of the following tests.

1. You participate in the activity for more than 500 hours.
2. Your participation was substantially all the participation in the activity of all individuals for the tax year, including the participation of individuals who did not own any interest in the activity.
3. You participated in the activity for more than 100 hours during the tax year, and you participated at least as much as any other individual (including individuals who did not own any interest in the activity) for the year.
4. The activity is a significant participation activity, and you participated in all significant participation activities for more than 500 hours. A significant participation activity is any trade or a business activity in which you participated for more than 100 hours during the year and in which you did not materially participate under any of the material participation, other than this test.
5. You materially participated in the activity for any 5 (whether or not consecutive) of the 10 immediately preceding tax years.

6. The activity is a personal service activity in which you materially participated for any 3 (whether or not consecutive) preceding tax years. An activity is a personal service activity if it involves the performance of personal services in the fields of health (including veterinary services), law, engineering, architecture, accounting, actuarial science, performing arts, consulting, or any other trade or business in which capital is not a material income-producing factor.

7. Based on all the facts and circumstances, you participated in the activity on a regular, continuous, and substantial basis during the year.

You did not materially participate in the activity under test (7) if you participated in the activity for 100 hours or less during the year. Your participation in managing the activity does not count in determining whether you materially participated under this test if any person other than you received compensation for managing the activity, or any individual spent more hours during the tax year managing the activity than you did.

There are special rules applicable to limited partners. If you owned an activity as a limited partner, you generally are treated as not participating in the activity. You can be treated as materially participating in the activity if you met test 1, 5, or 6 under the material participation tests above.

An estate or trust will be treated as materially participating in an activity if the fiduciary of the estate or trust participates in the activity, in its fiduciary capacity, on a regular, continuous, and substantial basis. The seven tests for individuals do not apply to estates and trusts.

## Rental Activities

A rental activity is generally a passive activity regardless of whether you materially participate. A rental activity is an activity where payments are principally for the use of tangible property (real or personal) that is used or held for use by customers. However, your activity involving the use of tangible property is not a rental activity under Regulation section 1.469-1T(e)(3)(ii). If any of the following apply:

- The average period of customer use of the property is 7 days or less.
- The average period of customer use is 30 days or less and you provide significant personal services with the rental.
- You provided extraordinary personal services in connection with making such property available for customer use.
- You provide the property for use in a non-rental activity in your capacity as an owner of an interest in the partnership, S corporation, or joint venture conducting that activity.

If you meet one of the exceptions listed above, the income will not be from a passive activity if you materially participated in the activity for the tax year. However, your income from the activity is included in Net Investment Income even if you meet one of the exceptions and materially participated in the activity if within the meaning of section 162.

## Real Estate Professionals

If you are a real estate professional for purposes of section 469, your rental income, or loss will not be passive if you materially participated in the rental real estate activity. For additional information on real estate professionals, see IRC 469(c)(7) and Publication 925.

However, your rental income is included in Net Investment Income if the income is not derived in the ordinary course of a trade or business. **Qualifying as a real estate professional does not necessarily mean you are engaged in a trade or business with respect to the rental real estate activities.** If your rental real estate activity is not a section 162 trade or business or you do not materially participate in the rental real estate activities, the rental income will be included in Net Investment Income Tax.

## Re-characterization of Passive Income

The regulations under section 469 provide special rules that treat income from the following activities as not from a passive activity:

- Significant participation passive activities
- Rental of property if less than 30% of the unadjusted basis of the property is subject to Depreciation
- Passive equity-financed lending activities
- Rental of property incidental to a development activity
- Rental of property to a non-passive activity
- Acquisition of an interest in a pass-through entity that licenses intangible property

The income from these activities may be included in Net Investment Income if the income is not derived in the ordinary course of a trade or business and it constitutes income from interest, dividends, annuities, royalties, or rents. For example, net rental income from property rented to a non-passive activity (self-rental) that is not derived in the ordinary course of a trade or business will be included in net investment income. For more information on re-characterization of passive income, see Temporary Regulations section 1.469-2T(f), Regulations section 1.469-2(f), and Publication 925.



## Economic Grouping

You can treat one or more trade or business activities and rental activities as a single activity if those activities form an appropriate economic unit for measuring gain or loss under the passive activity loss rules. For additional information on passive activity grouping rules, see Publication 925.

The passive activity grouping rules determine the scope of your trade or business and whether that trade or business is a passive activity for purposes of Net Investment Income Tax. The proper grouping of a rental activity with a trade or business activity will not convert any gross income from rents into gross income derived from a trade or business.

In general, once you make a grouping decision, you may not regroup those activities in later taxable years unless the original grouping was clearly inappropriate or there has been a material change in facts and circumstances that make the original grouping clearly inappropriate. However, you may regroup your activities under a regrouping "fresh start" for tax years that begin in 2013. The election to regroup your activities under the "fresh start" must be made in the first year you are subject to the net investment income tax. In other words, in the first year in which you have net investment income and your modified adjusted gross income exceeds the statutory threshold amount. The determination of whether you met the Net Investment Income Tax applicable income threshold and have net investment income is made without regard to the effect of the regrouping. You may only regroup activities once under the Net Investment Income Tax "fresh start" and any such regrouping will apply to the taxable year for which the regrouping is done and all subsequent year.

### Disclosure Requirements

For tax years beginning after January 24, 2010, you are required to report certain changes to your groupings that occur during the tax year to the IRS. Regroupings under the Net Investment Income Tax "fresh start" are subject to these disclosure requirements. See Revenue Procedure 2010-13 and Publication 925.

## Specific Instructions

### Part I—Investment Income

#### Section 6013(g) Election

In general section 6013(a) provides that no joint return may be made by married taxpayers if either spouse is a nonresident alien at any time during the taxable year. Section 6013(g), however, generally

permits a nonresident alien individual married to a citizen or resident of the US to elect for purposes of chapter 1 and chapter 24 of the Code to be treated as a resident of the US.

Proposed regulation 1.1411-2(a)(2)(i) (B) provides that married taxpayers who file a joint Federal income tax return pursuant to a section 6013(g) election can also elect to be treated as making a section 6013(g) election for purposes of chapter 2A of the Code by checking the box for section 6013(g) election.

If you make this election, you will include both your nonresident spouse and your net investment income together in determining the tax and use the threshold amount for married filing jointly.

#### Regulation Section 1.1411-10(g) Election

Proposed regulations 1.1411-10(g) allows individuals, estates, and trusts to make an election to include inclusions under section 951 and 1293 in net investment income in the same manner and in the same taxable year as such amounts are included in income for chapter 1 purposes.

If an individual, estate or trust makes the election, any section 959(d) or section 1293(c) distributions that are not treated as dividends for chapter 1 purposes are not treated as dividends for section 1411 purposes, and thus would not be included in next investment income for section 1411 purposes.

#### Making the Elections

An individual, estate or trust that wants to make the election generally must do so for the first taxable year beginning after December 31, 2013, during which (1) the individual, estate or trust owns and interest in a CFC or PFIC, and (2) the individual, estate, or trust is subject to tax under section 1411 or would be subject to tax under section 1411 if the election under proposed regulations 1.1411-10(g) is made.

The election may be made for a taxable year that begins before 1/1/2014. Once an election is made, it applies to all interests in CFCs and PFICs, including CFCs and PFICs that subsequently are acquired by the electing taxpayer. The election cannot be revoked, except with the Commissioner's consent.

Determination whether an individual, estate or trust is subject to tax under section 1411 for a taxable year is based on whether the individual's modified adjusted gross, or the estate's or trust's adjusted gross income, exceeds the applicable threshold regardless of whether the individual, estate, or trust has an income inclusion under section 951(a) or section 1293(a), or receives a distribution

of previously taxed income with respect to any CFC or QEF in that taxable year.

**Example.** If in 2014, a single individual acquires an interest in a QEF, has a QEF inclusion of \$5,000.00, and has modified adjusted gross income of \$150,000.00, the individual would not have to make an election for 2014 because section 1411 is not applicable. If in 2015, the individual has modified adjusted gross income in excess of 200,000, and the individual would like to take QEF inclusions into account for purposes of section 1411 in the same manner and in the same taxable year as such amounts are taken into account for chapter 1 purposes, the individual must make the election for 2015 in the time and manner described in proposed 1.1411-10(g).

#### Line 1—Taxable Interest

Enter your total taxable interest income from Form 1040, line 8a, estate or trust's total taxable interest income from Form 1041, line 1.

Excluded is the interest income earned in the ordinary course of your non-1411 trade or business.

All substitute interest from (Form 1040, line 21) are reported on line 7 of form 8960. These payments are reported to you in box 8 of Form 1099-MISC.

#### Line 2—Ordinary Dividends

Enter your total dividends income from Form 1040, line 9a, or total ordinary dividends reported on line 2a of form 1041. Enter the total of ordinary dividends reported to you on Form 1099MISC, box 2a (dividends) (2012 form) and the total of ordinary dividends reported to you on Form 1065 K-1, box 5a and on form 1120S K-1, box 6a. Alaska Permanent Fund is excluded from Net Investment Income per revenue ruling 90-56 All substitute dividends from (Form 1040, line 21) are report on line 7 of form 8960. These payments are reported to you in box 8 of Form 1099-MISC.

#### Line 3-Nonqualified Annuities, Endowments, or Life Insurance Contracts

Enter the taxable amount of all annuities received from nonqualified plans. Annuities received from both qualified and nonqualified plans are reported to the recipient on Form 1099R. However, only those annuities received from nonqualified plans are subject to the NIIT. Examples of annuities from nonqualified plans include private annuities and purchased commercial annuities. Annuities from nonqualified plans are identified with the special Distribution Code "D" in Box 7 of Form 1099-R for "Annuity payments from nonqualified annuities that may be subject to tax under section 1411".

The following annuities are not included in calculating your Net Investment Income.

- 401- Qualified pension, profit-sharing and stock bonus plans
- 403(a) - Qualified annuity plans purchased by an employer for an employee
- 403(b) - Annuities purchased by public schools or section 501(c)(3) tax-exempt organizations
- 408 - Individual Retirement Accounts
- 408A - Roth IRAs
- 457(b) - Deferred compensation plans of a State and local government and tax-exempt organization.

If Distribution Code D is shown in Box 7 of Form 1099-R, then include on Line 3 of Form 8960 the taxable amount reported in Box 2a of Form 1099-R. However, if the Payor checks Box 2b indicating the taxable amount cannot be determined, you may have to figure the taxable portion of your distribution. See Publication 939, General Rule for Pensions and Annuities, and Publication 575, Pension and Annuity Income, for details.

#### **Line 4a—Rental Real Estate, Royalties, Partnerships, S Corporations, Trusts, etc.**

Enter the total amount from Form 1040 Line 17; or Form 1041, Line 5.

#### **Line 4b—Adjustment for Net Income or Loss Derived in the Ordinary Course of a Non-Section 1411 Trade or Business**

Enter the net positive or net negative amount for the following items included in Line 4a that are not included in determining Net Investment Income.

- Net income or loss from a Section 162 trade or business that is not a passive activity.
- Net income or loss from a passive section 162 trade or business activity that is taken into account in determining self-employment income.
- Net rental income or loss of a Real Estate Professional where you materially participated in the rental real estate activity AND the activity rises to a Section 162 trade or business.
- Rents that are not from a passive activity, but are derived in the ordinary course of a trade or business.
- Net rental income or loss from a rental that meets an exception under Regulations 1.469-1T(e)(3)(ii) AND the activity rises to a Section 162 trade or business AND you materially participated in the activity.
- Other rental income or loss reported from a partnership, 1120S, or trust via K-1, Line 3, where the activity is not a passive

activity and rises to the level of a Section 162 trade or business.

- Net income that has been re-characterized as not from a passive activity under the passive loss rules and is derived in the ordinary course of a Section 162 trade or business.
- Net income from property rented to a non-passive activity (Self-rental that is a Section 162 trade or business AND has been re-characterized as not from a passive activity under the passive loss rules).
- Net income from the rental of property with less than 30% of the unadjusted basis subject to depreciation (Land) that is a Section 162 trade or business AND has been re-characterized as not from a passive activity under the passive loss rules.
- Royalties derived in the ordinary course of a section 162 trade or business that is not a passive activity.

#### **Line 5a—Net Gains on Dispositions of Property From Form 1040**

Combine Form 1040, lines 13 and 14; or combine Form 1041, lines 4 and 7.

#### **Line 5b—Net Gain or Loss from Disposition of Property That is Not Subject to Net Investment Income Tax**

The following lines included in Line 5a are excludable from Net Gains on disposition of property:

- Gain from the sale of property held in a trade or business that is not a passive activity.
- Gain from a distribution in excess of basis from partnership or S corporation that is not a passive activity.

Net Gain attributable to the disposition of property not held in a trade or business. The general income tax gain and loss recognition rules in Chapter 1 of the Code apply for purposes of determining net gain under Section 1411. The general income tax rules in Chapter 1 of the Code generally will determine whether there has been a disposition of property under Section 1411. Proposed regulations 1.1411-(4)(1) uses the term net gain, which contemplates a positive number, the proposed regulations provide that the amount of net gain included in net investment income may not be less than zero. Section 1411(c)(1)(A)(iii) net investment income includes net gain attributable to the disposition of property. Net gain attributable to the sale, exchange, or other disposition of property not used in a trade or business or used in a trade or business that is a passive activity or is trading in financial instruments or commodities. Property held in a passive activity or used in trading

financial instruments or commodities is subject to the 3.8% tax. Rules for the disposition of interests in partnerships and S corporations maybe adjusted per proposed Regulations Section 1.1411-7. In the case of an individual who is directly engaged in the conduct of a trade or business the determination of whether net gain from the disposition is attributable to property "held" in a trade or business is made at the individual level. Capital losses in excess of capital gains generally are not recognized for purposes of Section 1411, losses allowable under Section 1211(b)(1) and (2) are permitted to offset gain from the disposition of assets other than capital assets that are subject to Section 1411.

#### **Substantially appreciated property.**

Section 1.469-2(c)(2)(iii)(A) generally provides that if an interest in property used in an activity is substantially appreciated at the time of disposition any gain from the disposition shall be treated as not from a passive activity. The re-characterized gain may be taken into account under Section 1411(c)(1)(A)(iii) if the gain is attributable to the disposition of property.

**Pass-through Entities.** If you hold an interest in a pass-through entity, the determination of business engaged in a trade or business is made at the entity level. A distribution of money in excess of the adjusted basis of a partner's interest in the partnership which recognizes gain under Section 731(a) or a shareholder who receives a distribution of money in excess of the adjusted basis of the shareholder's stock in the corporation which recognizes gain under Section 1368(b)(2), the gain is treated as gain from the sale of exchange of such partnership interest of S Corporation stock for purposes of Section 1411(c)(1)(A)(iii).

#### **Line 5c—Adjustment From Disposition of Partnership Interest or S Corporation Stock**

**Disposition of interest in a Partnership and S Corporation.** An interest in a partnership or S Corporation is not property held for use in a trade or business. Gain or loss from the sale of a partnership interest or S Corporation stock will be subject to Section 1411(c)(1)(A)(iii) A transferor of an interest in a partnership or S Corporation in a similar position as if the partnership or S corporation had disposed of all the its properties and the accompanying gain or loss from the disposition of such properties flowed through to it owners. 1. may be a disparities between the transferor's adjusted basis in the partnership interest or S Corporation stock and the entity's adjusted basis in the underlying properties. 2. The sales price of the interest may not reflect the proportionate share of the underlying properties' fair

market value with respect to the interest sold. In order to achieve parity between an interest sale and an asset sale, Section 1411(c)(4) must be applied on a property-by-property basis. This will require a determination of how the property was used in order to determine whether the gain or loss to the transferor from the hypothetical disposition of such property would have been gain or loss subject to Section 1411(c)(1)(A)(iii). This is applicable if disposed property is not used in trade or business or is passive or sale of financial instruments.

**Passive activities.** 1411(c)(1)(A) and 1411(c)(2)(A) is intended to take into account only gross income from the net gain attributable to passive activity

**Shareholders of controlled foreign corporations.**

## Line 5d

### Line 6—Traders in Financial Instruments or Commodities

**Investor:** An investor is a person who purchases and sells securities with the main purpose of realizing investment income in the form of interest, dividends, and gains from appreciation in value over a relatively long period of time. An investor is never considered to be engaged in a Section 162 trade or business of investing. Gains and Losses will be reported on schedule D and expenses on Schedule A, Miscellaneous Expenses. Interest and Dividends will be included on line 1 and 2 of NII form/schedule The management of one's own investments is not considered a Section 162 trade or business no matter how extensive or substantial the investment might be.

**Trader:** A trader seeks profit from short-term market swings and receives income principally from selling on an exchange rather than from dividends, interest, or long-term appreciation. Traders do not have customers A trader will be deemed to be in a trade or business as described in Section 162, if the taxpayer trading is frequent, regular, and continuous. Can have a negative on the reporting of trading transactions A Trader would report gains and losses on schedule D unless the 475(f)(1) and/or 475(f)(2) were made timely. If 475(f) election is made timely the taxpayer should report all sales of the covered by the elections on form 4797 and expenses on schedule C. Not all transactions are involving financial instruments will necessarily be covered by the elections, so an electing TP might actually have to file a form 4797 and a schedule D, rare but possible

The taxpayer who is deemed a trader will file a schedule C for expenses regardless if the 475(f) election was made.

**Dealer:** Reports income and expenses on schedule C, but can file a corporate or partnership return. Dealers do not report on a schedule D or form 4797. Because dealers file a Schedule C they are not subject to Section 1411 because they are subject to SECA tax already. A taxpayer is a dealer if, in the ordinary course of a trade or business, the taxpayer regularly purchases securities from or sells securities to customers or regularly offers to enter into either side of the securities transactions with customers.: Inclusions and Deductions that arise because a taxpayer has elected to mark to market stock of a passive foreign investment company under Section 1296 are deemed to be attributable to the disposition of property for purposes of Section 1411. Accordingly, the amounts included in income under Section 1296(a)(1) and amounts allowable as a deduction under Section 1296(a)(2) are taken into account in computing net gain for purposes of Section 1411.

**Trading in Financial Instruments or Commodities,** income from such trade or business retains its character as it flows up to the taxpayer. Such income will not qualify for the ordinary course exception in Section 1411(c)(1)(A)(i). If a Financial or Commodities Trader makes the election under Section 475 all trading is reported on Schedule 4797. Expense will be reported on Schedule C Financial Traders under section 1256 contracts will report on Form 6781, which is then carried over to Schedule D.

### Line 7—Other Modifications to Investment Income

#### Controlled Foreign Corporation (CFC) and Passive Foreign Investment company (PFIC)

Income with respect to investments in CFCs and PFICs generally is included in the calculation of net investment income. For instance, chapter 1 dividends derived from a CFC or a PFIC are included on line 2 of Form 8960, and chapter 1 gains and losses derived with respect to the stock of a CFC or a PFIC are taken into account in calculating net gain from the disposition of property on line 5d of Form 8960. Moreover, income derived with respect to CFCs and certain PFICs held in a trade or business described in section 1411(c)(2) is reported on line 4b of Form 8960.

In addition, certain rules apply if you own an interest in a CFC or PFIC, which may vary depending upon which set of anti-deferral rules apply to your CFC or PFIC interest, and depending upon whether you make a certain election provided in the proposed section 1411 regulations. In general, if you are subject to the section 1296 mark to market rules

with respect to a PFIC, you will take into account for net investment income purposes any amounts included in income under section 1296(a)(1) and any amounts deducted from income under section 1296(a)(2). In addition, if you are subject to the section 1291 rules with respect to a PFIC, then you will include in net investment income "excess distributions" that are dividends, as well as gains that are treated as "excess distributions." Your treatment with respect to a CFC or qualified electing fund (QEF) will depend on whether you make an election pursuant to proposed Regulation section 1.411-10(g). If you make the election, then you will take into account for net investment income purposes any inclusions under sections 951(a) and 1293(a). If you do not make the election, then you will take into account for net investment income purposes certain distributions from the CFC and QEF that are not subject to tax for chapter 1 purposes. In addition, other special rules apply, including rules that provide for alternative basis calculations with respect to your basis in a CFC or QEF, and your basis in a partnership or S corporation that owns an interests in a CFC or QEF. For additional information, see proposed regulation section 1.411-10.

If you own an interest in a CFC or a PFIC (other than certain CFCs and PFICs held in a trade or business described in section 1411(c)(2)) you will need to complete either Worksheet A or Worksheet B. If you own an interest in a CFC or QEF and made the election pursuant to proposed regulation section 1.411-10(g), use Worksheet A to determine the amount to include on line 7 with respect to your interests in CFCs and PFICs. If you own an interest in a CFC or PFIC and did not make the election pursuant to proposed regulation section 1.411-10(g), use Worksheet B to determine the amount to include on line 7 with respect to your interests in CFCs and PFICs. For more information about determining the amounts to report on Worksheet A and Worksheet B, see proposed regulation to section 1.411-10. (See the instructions for line 4b and 5b for additional information regarding the reporting of amounts derived with respect to CFCs and PFICs.)

#### Charitable Remainder Trust (CRT).

An annuity and/or a unitrust distribution may be net investment income to the recipient.

**Form 8814 election.** Parents electing to include their child's dividends and capital gain distribution in their income by filing Form 8814: If the amount on form 8814 line 4 is 1900 or less subtract 950 from the line 4 amount and include on this line (other NII income, currently line 6). If any



amount on line 4 includes Alaska Permanent Fund dividends, subtract that amount as well. If the amount on form 8814 line 4 is greater than 1900, include the amount on Form 8814 line 12 on this line (other NII income, currently line 6). If any amount on line 4 includes Alaska Permanent Fund dividends, subtract that amount. If you are a partner in an Electing Large Partnership and receive a Form 1065 B K-1 and box/line 2 contains a loss, report this loss here as a negative modification.

## Line 8—Total Investment Income

## Part II—Investment Expenses Allocable to Investment Income and Modifications

The investment interest expense you paid or accrued during the tax year is an allowable deduction in determining your net investment income tax for the year. Investment interest expense is interest that you paid on money you borrowed for property held for investment. Your net investment interest expense is limited to your net investment income. It does NOT include any interest you paid which is allocable to passive income for an activity in which you did not materially participate, or to securities that generate tax-exempt income. Form 4952 is completed to figure your investment interest expense deduction, unless all three of the following conditions apply:

1. Your investment interest expense is not more than your investment income from interest and ordinary dividends minus any qualified dividends.
2. You have no other deductible investment expenses
3. You have no disallowed investment interest expense If all three conditions apply, your investment interest expense is reported on line 14 of Schedule A of Form 1040.

## Line 9a—Investment Interest Expenses

Enter on Line 9a of the Net Investment Income Tax Form the investment interest expense you paid or accrued during the tax year from either line 14 of Schedule A or the amount from line 8 of Form 4952. For further details, refer to the instructions to Form 4952 or to Publication 550, Investment Income and Expenses.

## Line 9b—State Income Tax

Include on line 9b any state or local income taxes, or foreign income taxes you paid which are attributable to net investment income. This may be all or part of the amount you reported on line 5a of

Schedule A of Form 1040. Examples include state or local income taxes that were withheld and reported on either Form 1099-MISC or Form 1099-R, state or local income taxes you paid in the current year for a prior year, estimated tax payments you made during the year to a state or local government, or foreign income taxes imposed on you from a foreign country or U.S. possession as long as these taxes are attributable to net investment income. You can determine the portion of your state and local income taxes allocable to net investment income using any reasonable method. An allocation based on the ratio of your net investment income to the amount of your total gross income is a reasonable method which is illustrated below:

**Example.** A, an unmarried individual has adjusted gross income in year 1 of \$280,000 which includes wages of \$210,000 and interest income of \$70,000. A's deductions on Schedule A as itemized deductions includes State income taxes of \$30,000. \$7,500 is the amount of state income tax paid that is attributable to net investment income. As determined below:  $(\$70,000 \div \$280,000) \times \$30,000 = \$7,500$

**Note.** The state/local income tax information sections of Forms 1099-MISC and 1099-R do not have to be completed by the employer. These are included for taxpayer convenience only.

## Line 9c—Miscellaneous Investment Expenses

Investment expenses that you incur which are directly connected to the production of investment income are deductible expenses in determining your net investment income. These expenses can include investment fees, custodial fees, any fees paid to collect interest and dividends, certain legal and accounting fees, or clerical help and office rent paid in order to care for your investments. These do not include investment interest expenses which are deductible on Line 8(a) of this Form. Investment expenses directly connected to the production of investment income are reportable as Miscellaneous Itemized Deductions on Schedule A (Form 1040), Line 23. These expenses are subject to the 2% of adjusted gross income limitation. You may also have investment expenses attributable to flow-through entities such as partnerships, S corporations and mutual funds that are not publicly offered. Partners or shareholders can deduct their share of passed-through deductions for investment expenses as Miscellaneous Itemized Deductions subject to the 2% limit. Enter on Line 1 of Worksheet A of this Form, the total amount of investment expenses from Line 23 of Schedule A, that were

attributable to the production of investment income.

## Line 9d

## Line 10—Additional Modifications

Beneficiaries who receive Form 1041 K-1s: If an amount is reported in box/line 5 - Other portfolio and nonbusiness income - please check to see if an amount is also reported in box/line 14, Other information, Code "I". If an amount is reported with that code, place that amount as a negative modification on this line - Additional Modifications.

**Special rule for traders in financial instruments or commodities.** Gains and losses from selling securities as a trader in financial instruments or commodities are not subject to self-employment taxes. However, interest expense and other investment expenses for a trader are deducted by a trader on Schedule C (Form 1040), Profit or Loss From Business, if the expenses are from the trading business. Proposed regulations 1.1411-9(b) provides a special rule for a trader with interest and other investment expenses to reduce investment income. Investment income may be reduced by a trader's interest and other investment expenses to the extent the expenses are not used to reduce the trader's self-employment income. If the trader only maintains trade or businesses as a trader the trader does not have self-employment income because gains and losses from selling securities as a trader in financial instruments or commodities are not subject to self-employment taxes. So a trader with only one trade or business can include all these expenses as a modification on Line 10. If the trader maintains another trade or business, the trader may be able to include some or all of the interest or other investment expenses from the trading business reported on the Schedule C as a modification on Line 10. To determine whether a trader can include the interest and other investment expenses as a modification on Line 10, the trader will need to complete Schedule SE (Form 1040), Self-Employment Tax, The trader should use the worksheet below to determine whether any of the interest or investment expenses from the trading business should be included as a modification on Line 10.

If Line 3 on the Schedule SE is zero or a positive amount the expenses can not be included as a modification on Line 10. If Line 3 of the Schedule SE is a negative amount, complete the worksheet to determine the amount of the expenses that can be included as a modification on Line 10.

**Note.** Although Schedule SE must be completed to determine the amount of expenses that may be used as a modification on Line 10, if Line 3 of the Schedule SE is a negative amount, do not file the Schedule SE with your Form 1040. See the instructions for Schedule SE for who must file a Schedule SE. Retain the Schedule SE and the worksheet used to determine the expenses included as a modification on Line 10 with your records. Do not file the worksheet with Form 1040.



*Under no circumstances will a net operating loss deduction be taken into account in determining net investment income in any year.*

**Line 11—Total Deductions and Modifications**

**Part III—Tax Computation**

**Line 12—Net Investment Income**

Subtract line 11 from line 8. If zero or less, stop here, you do not need to file this form.

**Line 13—Modified Adjusted Gross Income**

Modified adjusted gross income is adjusted gross income increased by the amount excluded from income as foreign earned income under section 911(a)(1); over the amount of any deductions taken into account in computing adjusted gross income or exclusions disallowed under section 911(d)(6) with respect to the amounts described in paragraph (c)(1)(A)

In addition, shareholders of CFCs and PFICs who have not made the election provided under proposed Regulations section 1.411-10(g) must adjust their modified adjusted gross income as provided in proposed Regulations section 1.411-10(e)(1).

**Line 14—Threshold Based on Filing Status**

Filing Status	Threshold Amount
Married Filing Jointly	\$250,000
Surviving Spouse	\$250,000
Married Filing Separately	\$125,000
Any other (Single or Head of Household)	\$200,000

**Line 17—Net Investment Income**

**Estates and Trusts**

**Line 18b—Deductions for Distributions of Net Investment Income and Deductions Under Section 642(c)**

Report the amount of net investment income distributed to beneficiaries of the estate or trust and the amount of net investment income allocated to distributions to charity pursuant to section 642(c). The amount of the deduction for net investment income distributed to charities under section 642(c) shall be the amount of the net investment income allocated to the charity in accordance with regulation section 1.642(c)-2(b) and the allocation and ordering rules under regulation section 1.662(b)-2.



*Form 1041, Schedule A, provides for a calculation of a trust's charitable deduction for regular tax purposes. Form 1041, Schedule A, can be used as a worksheet to calculate the amounts of net investment income allocable to charitable distributions. For the worksheet, the Form 1041, Schedule B, Line 2, includes both tax-exempt income and the difference*

*between adjusted total income and Form 8960, Line 18a. See Instructions for Form 1041, Schedule B, and regulation section 1.1411-3(e) for more information.*

The amount of the deduction for net investment income distributed to beneficiaries should equal the sum of net investment income reported to the beneficiaries on their respective Form 1041, Schedule K-1's.



*Form 1041, Schedule B, provides for a calculation of a trust's income distribution deduction for regular tax purposes. Form 1041, Schedule B, can be used as a worksheet to calculate the income distribution deduction for net investment income tax purposes. On this worksheet, Form 1041, Schedule B, Line 1, is replaced with the trust's net investment income from Form 8960, Line 18a. Form 1041, Schedule B, Line 2, includes both adjusted tax-exempt interest and the difference between Form 1041, Schedule B, Line 1, and Form 8960, Line 18a. See Instructions for Form 1041, Schedule B and regulation section 1.1411-3(e) for more information.*

**Line 19a—Adjusted gross Income**

Adjusted gross income (see instructions) - An estate or trust's adjusted gross income can be found in the instructions to Form 1041, Line 17. An estate or trust's adjusted gross income is adjusted upward or downward, as applicable, by the same amounts described in the instructions to Form 8960, Line 13.

**Line 19b—Highest Tax bracket for estates and Trusts**

Highest tax bracket for estates and trusts for the year (see instructions) - See instructions for Form 1041, Schedule G, 2012 tax rate schedule.

**Worksheet for Traders in Financial Instruments That Maintain More Than One Trade or Business—Line 10**

Keep for Your Records

Use this worksheet to determine the amount on line 10.

1	Enter the total amount from Line 3 of your 2012 Schedule SE (Form 1040) Self-Employment tax. ....	1	_____
2	a If the amount on Line 3 of your 2012 Schedule SE is zero or greater, you cannot use the expenses from your trade or business to reduce your investment income. Stop here.		
	b If the amount on Line 3 of your 2012 Schedule SE is a negative amount, enter your expenses from your trade or business. ....	2 b	_____
3	Add Line 1 to Line 2b. ....	3	_____
	a If the amount on Line 3 of this worksheet is zero or less, include the trade or business expenses (Line 2b of the worksheet) on Line 10 of Form 8960.		
	b If the amount on Line 3 of this worksheet is a positive number, convert the amount from Line 3 of your Schedule SE (Line 1 of this worksheet) into a positive number and include it on Line 10 of the Form 8960.		