**8569. When is an estate or trust subject to the investment tax?**

Certain trusts and estates are also subject to the 3.8% net investment income tax. Basically, the tax is imposed on any net investment income that remains in the estate or the trust and, thus, is not distributed to beneficiaries, otherwise referred to as “undistributed net investment income.” Unlike individual taxpayers, the threshold amount is the amount at which the highest regular income tax bracket begins. Additionally, unlike the applicable threshold amount for individuals, the applicable threshold is adjusted for inflation.[[1]](#endnote-1) For example, in 2014, the amount at which the highest income tax bracket begins is adjusted gross income in excess of $12,150. Since this amount is relatively low, many estates and trusts are likely to be subject to the tax.

The following examples are used to demonstrate the computation of the net investment income tax for a trust.

*Example*: In 2014, the Dinosaur trust has AGI of $16,000 and undistributed net investment income of $6,000.

The net investment income tax is imposed on trusts and estates on the lesser of:

1. Undistributed Net Investment Income, $6,000: or
2. The excess of (i) AGI of $16,000, over (ii) $12,500, the amount at which the highest regular tax bracket begins, or $3,850.

Even though there is $6,000 of undistributed net investment income, because the lesser of the two amounts is $3,850, only that amount is subject to the 3.8% net investment income tax.

*Example*: In 2015, the Dinosaur trust has AGI of $20,000 and undistributed net investment income of $6,000.

The net investment income tax is imposed on trusts and estates on the lesser of:

1. Undistributed Net Investment Income, $6,000: or
2. The excess of (i) AGI of $20,000, over (ii) $12,500, the amount at which the highest regular tax bracket begins, or $7,850.

Because the lesser of the two amounts is the undistributed net investment income of $6,000, the entire amount of undistributed net investment income is subject to the 3.8% net investment income tax.

**8569.02 Which trusts are not subject to the net investment income tax?**

Trusts not subject to the net investment income tax include charitable trusts exempt from tax under IRC Section 501[[2]](#footnote-1) or IRC Section 664[[3]](#footnote-2) (charitable remainder trusts) and trusts that are not classified as “trusts” for federal income tax purposes.[[4]](#footnote-3) Moreover, if all of the remaining interests in a trust are designated for certain qualified purposes, the trust is not subject to the net investment income tax. These qualified purposes described in IRC Section 170(c)(2)(B) include religious, charitable, scientific, literary or educational purposes.[[5]](#footnote-4)

Finally, grantor trusts such as revocable trusts are not subject to the net investment income tax. This is because the income of a grantor trust is taxed directly to the grantor. As a result, any net investment income generated by the trust is included in the grantor’s net investment income – potentially subject to the 3.8% tax.[[6]](#footnote-5)

1. . IRC Sec. 1411(a)(2)(B)(ii). [↑](#endnote-ref-1)
2. . Treas. Reg. §1.1411-3(b)(1)(ii). [↑](#footnote-ref-1)
3. . Treas. Reg. §1.1411-3(b)(1)(iii). [↑](#footnote-ref-2)
4. . Treas. Reg. §1.1411-3(b)(1)(iv). [↑](#footnote-ref-3)
5. . Treas. Reg. §1.1411-3(b)(1), IRC Sec. 170(c)(2)(B). [↑](#footnote-ref-4)
6. . Treas. Reg. §1.1411-3(b)(1)(v). [↑](#footnote-ref-5)