

SPOKANE ESTATE PLANNING COUNCIL

September 13, 2011

TRUST AND ESTATE UPDATE: Late breaking news....

Update to materials on Page 22. Investment Fees Paid by Trusts and Estates

Friday, September 2, 2011:

Treasury's Priority Guidance Plan for 2011-2012 was released. The first item listed in the category "GIFTS and ESTATES and TRUSTs" is "Regulations under §67 regarding miscellaneous itemized deductions of trusts and estates."

Tuesday, September 6, 2011:

Treasury Action: REG-128224-06 was issued. The document withdraws the July 27, 2007 notice of proposed rulemaking under §67(a) and provides notice of new proposed rules under §67(a). ***That was quick!***

The comment period for these proposed regulations ends on December 7, 2011 and the public hearing is scheduled for December 19, 2011. The regulations will be effective for taxable years beginning on or after final regulations are published in the Federal Register. Realistically, don't expect final regulations until sometime in 2012. That means they'll most likely impact years after 2012.

The proposed regulations are included at the end of these supplemental materials. As expected they are consistent with the holding in Knight. The Court in Knight also provided support for what had been a controversial part of the original proposed regulations – the requirement to “un-bundle” a single fee that included both costs that are subject to the 2 percent floor and costs that are not. An exception to the “unbundling” requirement is provided in 1.67-4(c)(2) ”If a bundled fee is not computed on an hourly basis, only the portion of that fee that is attributable to investment advice is subject to the 2 percent floor; the remaining portion is not subject to that floor. However “....., payments made from the bundled fee to third parties that would have been subject to the 2-percent floor if they had been paid directly by the non-grantor trust or estate are subject to the 2-percent floor, as are any fees or expenses separately assessed by the fiduciary or other payee of the bundled fee (in addition to the usual or basic bundled fee) for services rendered to the trust or estate that are commonly or customarily incurred by an individual.”1.67-4(c)(2). The regulations describe the types of costs that will and will not be subject to the 2 percent floor:

(2) *Ownership costs.* Ownership costs are costs that are chargeable to or incurred by an owner of property simply by reason of being the owner of the property, such as condominium fees, real estate taxes, insurance premiums, maintenance and lawn services, automobile registration and insurance costs, and partnership costs deemed to be passed through to and reportable by a partner. For purposes of section 67(e), ownership costs are commonly or customarily incurred by a hypothetical individual owner of such property.

(3) *Tax preparation fees.* The application of the 2-percent floor to the cost of preparing tax returns on behalf of the estate, decedent, or non-grantor trust will depend upon the particular tax return. All estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax returns are not subject to the 2-percent floor. The costs of preparing other individual income tax returns, gift tax returns, and tax returns for a sole proprietorship or a retirement plan, for example, are costs commonly and customarily incurred by individuals and thus are subject to the 2-percent floor.

(4) *Investment advisory fees.* Fees for investment advice (including any related services that would be provided to any individual investor as part of an investment advisory fee) are incurred commonly or customarily by a hypothetical individual investor and therefore are subject to the 2-percent floor. However, certain incremental costs of investment advice beyond the amount that normally would be charged to an individual investor are not subject to the 2-percent floor. For this purpose, such an incremental cost is a special, additional charge added solely because the investment advice is rendered to a trust or estate instead of to an individual, that is attributable to an unusual investment objective or the need for a specialized balancing of the interests of various parties (beyond the usual balancing of the varying interests of current beneficiaries and remaindermen), in each case such that a reasonable comparison with individual investors would be improper.

(c) *Bundled fees—(1) In general.* If an estate or a non-grantor trust pays a single fee, commission, or other expense (such as a fiduciary's commission, attorney's fee, or accountant's fee) for both costs that are subject to the 2percent floor and costs (in more than a de minimus amount) that are not, then the single fee, commission, or other expense (bundled fee) must be allocated, for purposes of computing the adjusted gross income of the trust or estate in compliance with section 67(e), between the costs subject to the 2-percent floor and those that are not. Out-of-pocket expenses billed to the trust or estate are treated as separate from the bundled fee.

(2) *Exception.* If a bundled fee is not computed on an hourly basis, only the portion of that fee that is attributable to investment advice is subject to the 2percent floor; the remaining portion is not subject to that floor. In addition, payments made from the bundled fee to third parties that would have been subject to the 2-percent floor if they had been paid directly by the non-grantor trust or

estate are subject to the 2-percent floor, as are any fees or expenses separately assessed by the fiduciary or other payee of the bundled fee (in addition to the usual or basic bundled fee) for services rendered to the trust or estate that are commonly or customarily incurred by an individual.

Example. A corporate trustee charges a percentage of the value of the trust income and corpus as its annual commission. In addition, the trustee bills a separate amount to the trust each year as compensation for leasing and managing the trust's rental real estate. The separate real estate management fee is subject to the 2-percent floor because it is a fee commonly or customarily incurred by an individual owner of rental real estate.

(3) *Reasonable Method.* Any reasonable method may be used to allocate a bundled fee between those costs that are subject to the 2-percent floor and those costs that are not, including without limitation the allocation of a portion of a fiduciary commission that is a bundled fee to investment advice. The reasonable method standard does not apply to determine the portion of the bundled fee attributable to payments made to third parties for expenses subject to the 2percent floor or to any other separately assessed expense commonly or customarily incurred by an individual, because those payments and expenses are readily identifiable without any discretion on the part of the fiduciary or return preparer.

(d) *Effective/applicability date.* These regulations apply to taxable years beginning on or after the date that these regulations are published as final regulations in the **Federal Register** .

Disclaimer and Circular 230 Disclosure:

The information contained in these materials is for education and instructional use only. No warranty, express or implied, is made as to their use. Any tax advice contained in these materials was not intended or written by the author to be used and it cannot be used by any taxpayer for the purposes of avoiding penalties that may be imposed on the taxpayer. Any tax advice contained in these materials was not written to support, within the meaning of Treasury Department Circular 230, the promotion or marketing of the transaction or matter addressed by such advice because the author has reason to believe that it may be used or referred to by another person in promoting, marketing or recommending an entity, investment plan or arrangement to one or more taxpayers. Before using any tax advice contained in these materials, a taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.