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Via Electronic Submission and Express Mail
http:// www.regulations.gov/
IRS - REG-128224-06

Internal Revenue Service
Attn: CC:PA:LPD:PR (REG-128224-06)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments to Proposed Treas. Reg. § 1.67-4 Concerning Whether Certain Costs Paid or Incurred by Estates or Non-grantor Trusts are Subject to the 2% of Adjusted Gross Income Floor

Dear Ladies and Gentlemen:

This letter sets forth the comments of the Association of the Bar of the City of New York to Proposed Treasury Regulation § 1.67-4, which was issued on July 27, 2007 (the "Proposed Regulations"). The Proposed Regulations address the exception to the 2-percent of adjusted gross income floor on miscellaneous itemized deductions (the "2% Floor") for certain costs that are paid or incurred in connection with the administration of an estate or a trust, and which would not have been incurred if the property were not held in such estate or trust.[1]

As discussed below, we strongly urge the Service to hold the Proposed Regulations in abeyance pending the Supreme Court's resolution of the Rudkin-Knight case,[2] which involves the construction of the specific statutory provision that is addressed by the Proposed Regulations, *to wit*, I.R.C. § 67(e) ("Section 67(e)"). We also request that the Service extend the comment period for the Proposed Regulations until 90 days after the Supreme Court decides Rudkin-Knight.

[1] The Proposed Regulations are reproduced in their entirety in the Appendix to these Comments.

[2] See Knight v. C.I.R., 127 S.Ct. 3005 (U.S. June 25, 2007) (granting petition for certiorari from the Second Circuit's decision in William L. Rudkin Testamentary Trust v. C.I.R., 467 F.3d 149 (2d Cir. 2006)).

With respect to the substance of the Proposed Regulations, we believe that the Proposed Regulations are unreasonable in construing Section 67(e) to require that "bundled" trustees' fees and commissions be unbundled, and note that the Service's position is contrary to the views expressed by each of the federal appellate courts that have commented upon (and approved) the deductibility of trustees' fees without regard to the 2% Floor.[3] We also regard the Proposed Regulations to be somewhat arbitrary in their delineation between those costs that the Service considers "unique" to an estate or a trust (and are therefore fully deductible without regard to the 2% Floor), and those costs that are not (which are therefore subject to the 2% Floor), and urge the Service to conform its classification scheme to the parameters that will soon be announced by the Supreme Court in the Rudkin-Knight case.[4]

I. The Proposed Regulations Should Be Held in Abeyance Pending the Supreme Court's Decision in the Rudkin-Knight Case and the Comment Period Should Be Extended until 90 Days after This Decision Is Rendered

We were surprised that the Proposed Regulations were issued so soon after the Supreme Court's granting of certiorari in the Rudkin-Knight case, which involves the construction of the specific statute (Section 67(e)) that the Proposed Regulations interpret. It would be unfortunate if the Service's actions served to undermine the balance of power among the judicial, executive and legislative branches of the United States government. Moreover, as a practical matter, if the Proposed Regulations are finalized without taking into consideration the Supreme Court's forthcoming decision in the Rudkin-Knight case, taxpayers might find themselves in a conundrum where different standards for interpreting Section 67(e) will have been promulgated by the Service and the Supreme Court -- thereby producing more litigation on this issue. Accordingly, we strongly urge the Service to reconsider its position, and to hold the Proposed Regulations in abeyance pending the resolution of the Rudkin-Knight case. In addition, to permit the Proposed Regulations to be evaluated in light of the Supreme Court's forthcoming guidance, we respectfully request that the Service extend the comment period for the Proposed Regulations until 90 days after the Supreme Court decides Rudkin-Knight.

II. The Proposed Regulations' Requirement that "Bundled Fees" be Unbundled Should Be Eliminated

We are troubled by certain substantive aspects of the Proposed Regulations, including the requirement that trustees' fees be unbundled between those that are unique to trusts and estates (which would not be subject to the 2% Floor) and those that are *not* unique to trusts and estates (which would be subject to the 2% Floor). This unbundling requirement in the Proposed Regulations is inconsistent with each of the four federal court of appeals decisions that

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[3] See Rudkin, 467 F.3d at 156; Scott v. United States, 328 F.3d 132, 140 (4th Cir. 2003).

[4] Although these Comments only address the specific points set forth herein, we fully adopt and agree with the positions taken by the Petitioner/Taxpayer in the Rudkin-Knight case. Given the Service's extensive familiarity with the issues presented in that case, we have not repeated those arguments here.

have construed Section 67(e),[5] and moreover is directly contrary to the views expressed by both the Second Circuit and the Fourth Circuit. As the Second Circuit succinctly put it:

> *"`[F]ees paid to trustees' . . . are fully deductible."*[6]

The Proposed Regulations disregard this critical aspect of the Second Circuit's decision in Rudkin, yet selectively choose from that same decision the Second Circuit's test for determining when costs incurred by a trust or estate are subject to the 2% Floor.[7]

We do not believe that the Proposed Regulations' requirement that trustees' fees be unbundled, and then classified as costs that either (i) are unique to trusts and estates, or (ii) are not unique to trusts and estates, constitutes a reasonable interpretation of the statute. Section 67(e) provides as follows:

> (e) DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS.-- For purposes of this section [67], the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that --
>
> (1) *the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate*, and
>
> (2) the deductions allowable under sections 642(b), 651 and 661, *shall be treated as allowable in arriving at adjusted gross income.* Under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter to take into account the provisions of this section.[8]

Significantly, nowhere in Section 67(e) is there any language that remotely suggests that the Service may "look through" the trustees' fees or commissions to determine their underlying classification. Accordingly, the unbundling requirement should be eliminated altogether.[9]

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[5] See Rudkin, supra note 2; Scott, supra note 3; Mellon Bank, N.A. v. United States, 265 F.3d 1275 (Fed. Cir. 2001); O'Neill v. Comm'r, 994 F.2d 302 (6th Cir. 1993).

[6] Rudkin, 467 F.3d at 156 (emphasis added) (quoting Scott, 328 F.3d at 140).

[7] Compare Rudkin, 467 F.3d at 156 (Section 67(e) permits a trust to take a full deduction (*i.e.*, without being subject to the 2% Floor) "only for those costs that could not have been incurred by an individual property owner.") with Prop. Treas. Reg. § 1.67-4(b) ("[A] cost is unique to an estate or a non-grantor trust if an individual could not have incurred that cost in connection with property not held in an estate or trust.").

[8] I.R.C. § 67(e) (emphasis added).

[9] The information systems of many institutional trustees are not currently equipped to accommodate unbundling trustees' commissions into unique and non-unique costs. Substantial additional expenditures would be required to generate the information needed in a form that is suitable to make this determination. Unfortunately, trust beneficiaries will often bear the ultimate cost of both the additional complexity and the lost income tax deduction.

III. The Service Should Await Guidance from the Supreme Court before Delineating Categories of Costs

The Proposed Regulations have attempted to draw a clear line between those expenses that are to be considered "unique" to an estate or a trust (and therefore deductible without regard to the 2% Floor), and those that are not unique (which would be subject to the 2% Floor). The Proposed Regulations consider the following expenditures "unique" to a trust or estate:

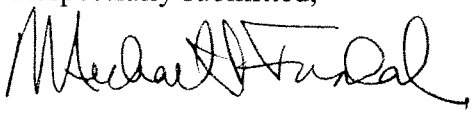
> (1) fiduciary accountings; (2) judicial or quasi-judicial filings required as part of the administration of the estate or trust; (3) fiduciary income tax and estate tax returns; (4) the division or distribution of income or corpus to or among beneficiaries; (5) trust or will contest or construction; (6) fiduciary bond premiums; and (7) communications with beneficiaries regarding estate or trust matters.[10]

In contrast, the Proposed Regulations consider the following products or services *not* to be unique to an estate or trust (and therefore subject to the 2% Floor):

> (1) custody or management of property; (2) advice on investing for total return; (3) gift tax returns; (4) the defense of claims by creditors of the decedent or grantor; and (5) the purchase, sale, maintenance, repair, insurance or management of non-trade or business property.[11]

Although we appreciate the Service's objective to provide taxpayers and their advisors with bright-line rules (notwithstanding that these rules may contain some internal inconsistencies), we believe that the better approach would be for any such guidelines to be informed by the standards that will soon be handed down by the Supreme Court in the Rudkin-Knight case. Accordingly, the issuance of these guidelines should be held in abeyance pending the Supreme Court's decision in Rudkin-Knight and the Service's review of comments to be submitted within 90 days after this decision is rendered.

Respectfully submitted,



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[10] See Prop. Treas. Reg. § 1.67-4(b).

[11] See id.

APPENDIX

Treas. Reg. § 1.67-4 -- Costs paid or incurred by estates or non-grantor trusts.

(a) In general. Section 67(e) provides an exception to the 2-percent floor on miscellaneous itemized deductions for costs that are paid or incurred in connection with the administration of an estate or a trust not described in § 1.67-2T(g)(1)(i) (a non-grantor trust) and which would not have been incurred if the property were not held in such estate or trust. To the extent that a cost incurred by an estate or non-grantor trust is unique to such an entity, that cost is not subject to the 2-percent floor on miscellaneous itemized deductions. To the extent that a cost included in the definition of miscellaneous itemized deductions and incurred by an estate or non-grantor trust is not unique to such an entity, that cost is subject to the 2-percent floor.

(b) Unique. For purposes of this section, a cost is unique to an estate or a non-grantor trust if an individual could not have incurred that cost in connection with property not held in an estate or trust. In making this determination, it is the type of product or service rendered to the estate or trust, rather than the characterization of the cost of that product or service, that is relevant. A non-exclusive list of products or services that are unique to an estate or trust includes those rendered in connection with: fiduciary accountings; judicial or quasi-judicial filings required as part of the administration of the estate or trust; fiduciary income tax and estate tax returns; the division or distribution of income or corpus to or among beneficiaries; trust or will contest or construction; fiduciary bond premiums; and communications with beneficiaries regarding estate or trust matters. A non-exclusive list of products or services that are not unique to an estate or trust, and therefore are subject to the 2-percent floor, includes those rendered in connection with: custody or management of property; advice on investing for total return; gift tax returns; the defense of claims by creditors of the decedent or grantor; and the purchase, sale, maintenance, repair, insurance or management of non-trade or business property.

(c) "Bundled fees." If an estate or a non-grantor trust pays a single fee, commission or other expense for both costs that are unique to estates and trusts and costs that are not, then the estate or non-grantor trust must identify the portion (if any) of the legal, accounting, investment advisory, appraisal or other fee, commission or expense that is unique to estates and trusts and is thus not subject to the 2-percent floor. The taxpayer must use any reasonable method to allocate the single fee, commission or expense between the costs unique to estates and trusts and other costs.

(d) Effective/applicability date. These regulations are proposed to be effective for payments made after the date final regulations are published in the Federal Register.