NEW YORK
CITY BAR

COMMITTEE ON
ESTATE AND GIFT TAXATION

MICHAEL I. FRANKEL
CHAIR
2 WALL STREET
NEW YORK, NY 10005
Phone: (212) 238-8802
Fax: (212) 732-3232
frankel@clm.com

RITA M. ANTONACCI
ACTING SECRETARY
2 WALL STREET
NEW YORK, NY 10005
Phone: (212) 238-8751
Fax: (212) 732-3232
antonacci@clm.com

June 10, 2008

Via Electronic Submission and Express Mail
Notice.Comments@irscounsel.treas.gov
Re: Notice 2008-32

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2008-32)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20224

Re: Comments to Proposed Treas. Reg. Section 1.67-4 & Notice 2008-32

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 Section 1.67-4, which was issued on July 27, 2007 (the "Proposed Regulations"), and Notice 2008-32, which was issued on February 27, 2008 (the "Notice").

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] Depending upon the facts and circumstances of the particular trust or estate, this exception can be significant because expenses subject to the 2% Floor may be effectively nondeductible as a result of the alternative minimum tax.

The Notice provides interim guidance to taxpayers in light of the Supreme Court's decision in Knight v. Commissioner, 128 S. Ct. 782 (2008) ("Knight"), and holds in abeyance the Proposed Regulations' requirement that fiduciary fees be unbundled for taxable years beginning before January 1, 2008. The Notice also requests comments concerning certain aspects of the Proposed Regulations, including the use of safe harbors and reasonable estimates by fiduciaries for unbundling fiduciary fees.

The following summarizes our position, with each of these points discussed in greater detail below:

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

1. The Proposed Regulations' requirement that bundled fees be unbundled should be eliminated as it is contrary to Section 67(e) of the Internal Revenue Code (the "Code") and the view expressed by each of the federal courts that have commented on the deductibility of fiduciary fees.

2. If the Internal Revenue Service (the "Service") will not eliminate its unbundling requirement, then a trust or estate should be allowed to deduct without regard to the 2% Floor the portion of its bundled fiduciary fee that would not be commonly incurred by individuals, as determined using any reasonable method of allocation that the fiduciary may select. The fiduciary's determination may take into account the exceptions set forth near the end of the Supreme Court's decision in Knight, including special additional charges that are applicable only to fiduciary accounts, and the incremental cost of expert advice beyond what would normally be incurred by individuals.

3. As an alternative, a fiduciary should be allowed as a safe harbor to deduct without regard to the 2% Floor the greater of (a) the amount of fiduciary commissions that would be allowed under applicable state law governing the commissions of individual fiduciaries, (b) a specified percentage of the fiduciary commissions (such as 50%), or (c) the amount allocable to fully deductible costs based upon the fiduciary's published fee schedule.

4. In determining the specified percentage in point 3, estates and trusts should be treated differently, and the safe harbor percentage for executors' commissions should be greater than the safe harbor percentage for trustees' commissions. For this purpose, executors' commissions should include the commissions of trustees of qualified revocable trusts that are described in Section 645 of the Code.

5. The Service should make other conforming changes to the Proposed Regulations in accordance with the Supreme Court's decision in Knight.

6. The Service should issue guidance to clarify that taxpayers (and tax practitioners) will not be subject to penalties relating to 2% Floor issues unless there is no reasonable basis for the taxpayer's position.

7. The final regulations under Section.67-4 (the "Final Regulations") should only apply to taxable years beginning on or after the later of January 1, 2009, or the year in which final regulations are issued.

I. The Proposed Regulations' requirement that "bundled fees" be unbundled should be eliminated.

We respectfully disagree with the Service's position under the Proposed Regulations and the Notice that bundled fiduciary fees should 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 the decision of each of the federal courts of

appeals that have commented on the deductibility of trustees' fees.[2] In this regard, the Second Circuit stated: "[F]ees paid to trustees' . . . are fully deductible."[3]

In addition, 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–
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> (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.[4]

Giving these words their ordinary meaning, trustees' commissions would not have been incurred if the property were not held in a trust. Significantly, nowhere in Section 67(e) is there any language that suggests that the Service should "look through" a fiduciary's fees or commissions to determine their underlying components.

Finally, the Proposed Regulations' insistence on unbundling, and the resulting burden that would be imposed upon fiduciaries to meet this requirement, is directly contrary to the uncontroverted congressional intent in enacting the 2% Floor to simplify recordkeeping for taxpayers. Unbundling would introduce complexity that would substantially increase the cost of administering trusts and estates.[5] Accordingly, the unbundling requirement should be eliminated.

II. If the Service will not eliminate its unbundling requirement, then a trust or estate should be allowed to deduct expenses without regard to the 2% Floor based upon any reasonable method of allocation that the fiduciary may select.

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[2] The four federal courts of appeals decisions that have construed Section 67(e) are: William L. Rudkin Testamentary Trust v. C.I.R., 467 F.3d 149 (2d Cir. 2006); Scott v. United States, 328 F.3d 132 (4th Cir. 2003); 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).

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

[4] I.R.C. Section 67(e)

[5] 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.

If the Service will not eliminate its unbundling requirement, then a trust or estate should be allowed to deduct without regard to the 2% Floor the portion of the bundled fiduciary fee that would not be commonly incurred by individuals as the fiduciary may determine, using any reasonable method of allocation that the fiduciary may select. In making this determination, in accordance with the Supreme Court's decision in Knight, the 2% Floor would not apply to the extent that special circumstances can be shown that involve additional charges that are applicable only to fiduciary accounts, or which generate incremental costs that an individual would not customarily incur. As the Supreme Court explained in Knight:

> "As the Solicitor General concedes, some trust-related investment advisory fees may be fully deductible 'if an investment advisor were to impose a special, additional charge applicable only to its fiduciary accounts.' There is nothing in the record, however, to suggest that [the investment advisor] charged the Trustee any differently than it would have treated an individual with similar objectives, because of the Trustee's fiduciary obligations. It is conceivable, moreover, that a trust may have an unusual investment objective, or may require a specialized balancing of the interests of various parties, such that a reasonable comparison with individual investors would be improper. In such a case, the incremental cost of expert advice beyond what would normally be required for the ordinary taxpayer would not be subject to the 2% floor. Here, however, the Trust has not asserted that its investment objective or its requisite balancing of competing interests was distinctive. Accordingly, we conclude that the investment advisory fees incurred by the Trust are subject to the 2% floor."[6]

Knight therefore sets forth a framework for this analysis that the Service should incorporate into the final regulations. Accordingly, the list of costs that are unique (and costs that are not unique) to trusts and estates that is provided in Proposed Treas. Reg. Section 1.67-4(b) should be revised to take Knight into account.

III. As an alternative, a fiduciary should be allowed to deduct without regard to the 2% Floor "safe harbor amounts."

As an alternative, a fiduciary should also be allowed to deduct without regard to the 2% Floor the greater of any applicable "safe harbor amount." Such safe harbor amounts may include:

(a) the amount of the trustees' commissions or executors' commissions that would be allowable for the taxable year under applicable state law governing individual trustees' commissions or individual executors' commissions, as the case may be,[7]

(b) a specified percentage of the fiduciary commissions (such as 50%), or

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[6] Knight, 128 S. Ct. at 791.

[7] The methodology for determining this safe harbor amount would vary from state to state. The computation of this amount could depend upon such matters as the value of the assets held in trust, and the amount of trust principal paid out to beneficiaries during the taxable year.

(c) the amount allocable to fully deductible costs based upon the fiduciary's fee schedule that is publicly available.

With regard to applicable state law, if the standard for fiduciary commissions is "reasonable compensation", the determination may be based upon customary state practice, as established by the fiduciary.

IV. Trusts and estates should be treated differently and the safe harbor percentage for executors' commissions should be greater than the safe harbor percentage for trustees commissions.

In determining the specified percentage in point III, an estate and a trust should be treated differently. Long-term investment management is generally not a primary function of an estate. Rather, collection of assets, payment of taxes and expenses, and the liquidation of assets to meet those needs as well as to facilitate distributions is often a primary responsibility of executors. For these reasons, we do not believe that unbundling of executors' commissions should be required, irrespective of whether trustees' commissions are required to be unbundled. If, however, the Service requires the unbundling of executors' commissions, then the specified safe harbor percentage of executors' commissions not subject to the 2% Floor should be greater than the specified safe harbor percentage applicable to trustees' commissions. For this purpose, executors' commissions should include the commissions of trustees of qualified revocable trusts that are described in Section 645 of the Code.

V. The Service should make other conforming changes indicated by the Supreme Court's decision in Knight.

In addition, the Service should include in the Final Regulations other conforming changes indicated by the Supreme Court's decision in Knight. These would include the following:

A. Clarifying that Section 67(e)(1) excepts from the 2% Floor "those costs that . . . would be uncommon (or unusual, or unlikely) for . . . a hypothetical individual to incur."[8]

According to the Supreme Court, the question whether a trust-related expense is fully deductible turns on a prediction about what would happen if the property were held by an individual rather than a trust. Thus, the critical question is whether costs incurred by a trust (including without limitation investment advisory fees) are customarily incurred outside of trusts.[9]

B. Clarifying, in accordance with the language appearing near the end of the Knight decision (as discussed in point II above), that the 2% Floor shall not apply to:

- special additional charges that are applicable only to fiduciaries or fiduciary accounts,[10] and

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[8] Knight, 128 S. Ct. at 790.
[9] See id. at 789-90.
[10] See id. at 791.

- the incremental cost of expert advice beyond what would normally be required for individuals.[11]

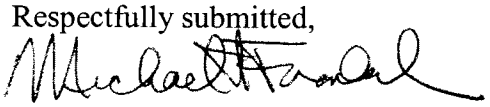
VI. Relief from penalties for 2% Floor determinations should be provided to both taxpayers and tax practitioners.

Further, given the difficulty of determining whether an individual would commonly incur a particular expense that has been incurred by a trust or estate, the Service should provide relief from penalties for taxpayers and tax practitioners. It should do so by clarifying that neither taxpayers nor tax practitioners shall be subject to penalties in connection with positions relating to Section 67(e) of the Code unless there is no reasonable basis for the taxpayer's position.

VII. The Final Regulations should only apply to taxable years beginning on or after the later of January 1, 2009 or the year following the year in which Final Regulations are issued.

The Proposed Regulations "are proposed to be effective for payments made after the date Final Regulations are published in the Federal Register."[12] So that taxpayers will not be unduly burdened with possibly having to apply two different sets of rules for bundled fiduciary fees, and other costs, that are paid or incurred during the same taxable year, the Final Regulations should only apply to taxable years beginning on or after the later of January 1, 2009, or the year following the year in which Final Regulations are issued.[13]

Respectfully submitted,



Michael I. Frankel
Chair, Estate & Gift Taxation Committee

Contributing members:
Kevin Matz
Lisa M. Stern
Sidney Smolowitz
Nancy S. Gabel
Ronnie Ringel

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[11] See id.

[12] Proposed Treas. Reg. Section 1.67-4(d).

[13] Given the significance of the Supreme Court's decision in Knight, we suggest that the Service consider issuing a second round of proposed regulations to allow for further comments.

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.