

2011 Supplement  
to  
Federal Income Taxation of Trusts and Estates:  
Cases, Problems, and Materials  
(Third Edition)

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## PREFACE

This supplement deals with developments we would have included in the casebook, had it gone to press in early February 2011.

Just this last December, nearly a decade after enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001, Congress finally returned to its one-year “repeal” of the estate tax and implementation of a highly modified version of carryover basis, and decided to wipe both off the books, except as to decedents who died in 2010 and whose executors elected not to be subject to the estate tax. Because both changes were, by their own terms, temporary, we have heretofore generally ignored them. Because the remaining scars affect only a few estates of decedents who have already died, we have chosen merely to acknowledge them here, rather than to clutter this supplement whenever there is a reference to either the estate tax or the basis of someone who takes property from a decedent.

Anyone who uses the casebook in class may reproduce this supplement for distribution to his or her students at cost.

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February 8, 2011

Page xli. In the second paragraph, replace the third, fourth, and fifth sentences with:

Twenty years later the Economic Growth and Tax Relief Reconciliation Act of 2001 implemented a phased-in increase of the estate tax exclusion to \$3,500,000, and the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 continued the trend, raising the exclusion to \$5,000,000, at least on a temporary basis. Plainly, the estate tax now applies to very small number of estates.

Page xli. In the third paragraph, replace the fourth sentence with:

Section 1(e) of the Code subjects trusts and estates to an onerously compressed rate schedule. For taxable years beginning after December 31, 2012, section 1411 will impose an additional tax equal in many instances to 3.8 percent of the “undistributed net investment income” of the trust or estate. One therefore ignores at one’s peril such topics as the distribution deduction and the grantor trust rules—mechanisms designed to shift the income tax liability of an estate or trust to one or more individuals, who are often taxed at considerably lower rates.

Page xli. Replace the third line from the bottom of the page with:

B. Abbin, *Income Taxation of Fiduciaries and Beneficiaries* (2010).

Page 46. At the end of the last paragraph on the page, add the following:

In Notice 2008-32, 2008-1 C.B. 593, however, the Service announced:

Taxpayers will not be required to determine the portion of a Bundled Fiduciary Fee that is subject to the 2-percent floor under § 67 for any taxable year beginning before January 1, 2008. Instead, for each such taxable year, taxpayers may deduct the full amount of the Bundled Fiduciary Fee without regard to the 2-percent floor. Payments by the fiduciary to third parties for expenses subject to the 2-percent floor are readily identifiable and must be treated separately from the otherwise Bundled Fiduciary Fee.

In Notice 2008-116, 2008-2 C.B. 1372, which modified and superseded Notice 2008-32, the Service extended its guidance to taxable years beginning before January 1, 2009. In turn, Notice 2010-32, 2010-1 C.B. 594, modified and superseded Notice 2008-116, extending the guidance to taxable years beginning before January 1, 2010.

For more on the applicability of section 67 in the context of trusts and estates, see Aucutt, *The “2% Floor” Grows Up—A Biography of Legislation, Litigation, and Regulations*, 33 ACTEC J. 214 (2008); Balter & Blattmachr, “Knight” Addresses 2 Percent Floor and Fiduciary Investment Advisory Fees, Daily Tax Rep. (BNA), Apr. 14, 2008, at J-1; Bekerman, *Was the Supreme Court Really Wearing Shining Armor? A Hard Day’s Knight for Trusts and Estates*,

Prob. & Prop., Sept./Oct. 2008, at 41; Roshkind, Comment, *Interpreting I.R.C. § 67(e): The Supreme Court's Attempt to Nail Investment Advisory Fees to the "Floor,"* 60 Fla. L. Rev. 961 (2008); Roy, Note, *Is That the End? Section 67(e) and Trust Investment Advisory Fees After Knight v. Commissioner*, 61 Tax Law. 321 (2007).

Page 86, note 4. Rev. Proc. 2008-3 (cited in this note) has been superseded. Rev. Proc. 2011-3, 2011-1 I.R.B. 111, 115, is to identical effect.

Page 218, note 3. Rev. Proc. 2008-3 (cited in this note) has been superseded. Rev. Proc. 2011-3, 2011-1 I.R.B. 111, 115, is to identical effect.

Page 223. Immediately following the *Nemser* opinion, add the following:

***Illustrative Material***

In Chief Couns. Adv. 201047021 (July 20, 2010), it appeared that the estate was insolvent, due to the decedent's unpaid tax liabilities. The administrator entered into a settlement agreement with the government, under which any assets that remained after payment of the administration expenses would go to the government. The administrator also procured an opinion from the estate's tax counsel to the effect that the residuary beneficiaries were nonetheless entitled to claim the estate's unused capital loss carryovers. The Service concluded otherwise, reasoning that because the settlement agreement had eliminated any possibility that the beneficiaries might actually receive anything, they were not "beneficiaries succeeding to the property of the estate." Under the Service's rationale, the carryovers would never be used.

Page 230. Delete from the assigned readings both provisions of the Internal Revenue Code. In 2010, Congress removed both provisions from the Code, except as to the estates of decedents dying in 2010 whose executors elected not to be subject to the estate tax. See Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 § 301(a), (c).

Page 261. At the end of the first paragraph in subdivision (B)(1)(b)(i), add the following:

*See generally* Akers, Blattmachr & Boyle, *Creating Intentional Grantor Trusts*, 44 Real Prop. Tr. & Est. L.J. 207 (2009).

Page 265, note 2. At the end of the second paragraph, add the following:

In 2009, the Treasury promulgated a new Table S, for single-life remainder factors, based on data from the 2000 census. *See* Temp. Reg. § 20.2031-7T(d)(7) (effective for transfers occurring on or after May 1, 2009).

Page 265, problem 4-7. In lieu of the last sentence, insert:

Consider Temp. Reg. § 20.2031-7T(d)(7), Table S.

Page 274. At the end of the “Illustrative Material,” add the following:

6. In Notice 2008-63, 2008-2 C.B. 261, the Service published a proposed revenue ruling relating to the income tax consequences of the use by a family of its own private trust company (PTC) to administer various family trusts in which the trustee has discretion to make distributions of income and principal, although not to the grantor. According to the Service, the ruling, when issued in final form,

will confirm certain tax consequences of the use of a private trust company that are not more restrictive than the consequences that could have been achieved by a taxpayer directly, but without permitting a taxpayer to achieve tax consequences through the use of a private trust company that could not have been achieved had the taxpayer acted directly.

The Service solicited public comments regarding the proposed ruling, particularly as to whether it would “achieve that intended result.”

In one situation considered by the proposed ruling, the trusts are governed by the laws of a state in which there is a statute under which PTCs are required to create a “Discretionary Distribution Committee (DDC)” and delegate to it “exclusive authority to make all decisions regarding discretionary distributions from each trust for which it serves as trustee.” The statute provides that “no member of the DDC may participate in the activities of the DDC with regard to any trust of which that DDC member or his or her spouse is a grantor, or any trust of which that DDC member or his or her spouse is a beneficiary” or with respect to “any trust with a beneficiary to whom that DDC member or his or her spouse owes a legal obligation of support.” The statute also provides that only the PTC’s officers and managers may make personnel decisions.

In a second situation, although the trusts are governed by the laws of a state in which there is no relevant statute, the PTC’s “governing documents create a DDC and delegate to the DDC the exclusive authority to make all decisions regarding discretionary distributions from each trust for which it serves as trustee.” The PTC’s governing documents also contain restrictions, similar to those in the statute discussed above, on the ability of DDC members to participate in decisions regarding discretionary distributions. In addition, the PTC’s governing documents provide for the creation of an “Amendment Committee, a majority of whose members must always be individuals who are neither Family members nor persons related or subordinate (as described in §672(c)) to any shareholder of PTC.” The PTC’s governing documents provide as well that the Amendment Committee has sole power, “by no less than majority vote,” to “make any changes to PTC’s governing documents regarding the creation, function, or membership of the DDC or of the Amendment Committee itself.” Likewise, the PTC’s

governing documents provide that only the PTC's officers and managers may make personnel decisions.

The Service concludes that a family's use of its own PTC as trustee of a family trust does not *alone* cause the grantor or any beneficiary to be treated as owner of the trust or any portion thereof under § 673, § 675, § 676, § 677, or § 678, in either the first or the second situation. The Service concludes that the applicability § 674 "will depend upon the particular powers of the trustee and may depend upon the proportion of the members of the DDC with authority to act with regard to that trust who are related or subordinate to the grantor." For this purpose, however, "the ownership of voting stock of PTC [by the grantor and the trust] shall be deemed to be not significant under § 672(c)." In support of this pivotal conclusion, the Service offers the following analysis:

"Voting control" is relevant insofar as it gives a grantor or trusts created by a grantor power over distributions made in the discretion of the corporate trustee or power over the employees of the corporate trustee who make such discretionary distribution decisions on behalf of the corporation. Under *Situation 1* and *Situation 2*, adequate safeguards protect against the exercise of such powers.

Instead, according to the Service, the applicability of § 674 may depend under § 672(c)(2) on whether "more than half" of the members of the DDC are nonadverse parties who are related or subordinate to the grantor: "In determining whether or not PTC as trustee is related or subordinate for purposes of [§ 672(c)(2)], one must look at the members of the DDC who are authorized to act with regard to that particular trust (as if those DDC members individually were the trustees)." The Service adds: "A subordinate employee of a corporation in which the grantor is an executive will still be deemed to be subordinate to the grantor under § 672(c)."

7. In Private Letter Rulings 200910008 & 200910009 (both dated 2008), the IRS concluded that a power to reacquire the trust assets by substituting property of equivalent value "affect[ed] beneficial enjoyment." Accordingly, the IRS ruled that section 674 treated the grantors as owners of the entire trust. For more than a decade, the IRS had refused, in countless private rulings, to assure taxpayers that such a power would trigger grantor trust status under the directly relevant provision, i.e., section 675(4)(C), on the theory it was impossible to know ahead of time whether the power was "exercisable in a nonfiduciary capacity . . . without the approval or consent of any person in a fiduciary capacity."

Page 376. After the period in line 16 of note 1, add the following:

*Compare Sparkman v. Commissioner*, 509 F.3d 1149 (9th Cir. 2007).

Page 376. At the end of note 1, add the following:

; *Richardson v. Commissioner*, 509 F.3d 736 (6th Cir. 2007); *Olsen v. Commissioner*, 96 T.C.M. (CCH) 415 (2008).

Page 376. After “In” in the third line from the bottom of the page, add the following:

*Tarpo v. Commissioner*, 98 T.C.M. (CCH) 283 (2009); *Richardson v. Commissioner*, 91 T.C.M. (CCH) 981 (2006), *aff’d*, 509 F.3d 736 (6th Cir. 2007);

Page 377. After “In” in the third line from the top of the page, add the following:

*Kierstead v. Commissioner*, 330 Fed. Appx. 126 (9th Cir. 2009), *Balice v. Commissioner*, 98 T.C.M. (CCH) 191 (2009), *Ioane v. Commissioner*, 97 T.C.M. (CCH) 1344 (2009), *Swanson v. Commissioner*, 96 T.C.M. (CCH) 379 (2008),

Page 377. After “*See also*” in the sixth line of note 3, add the following:

*United States v. Holland*, 637 F. Supp. 2d 315 (E.D.N.C. 2009) (property owned by family trust was subject to sale by government to satisfy grantor’s income tax liabilities);

Page 427. Delete the last two sentences of note 2. In 2010, Congress removed § 121(d)(11) from the Code, except as to the estates of decedents dying in 2010 whose executors elected not to be subject to the estate tax. See Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 § 301(a), (c).