



American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

May 2, 2012

The Honorable Max Baucus, Chairman
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Dave Camp, Chairman
House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Orrin G. Hatch
Ranking Member
Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sander M. Levin
Ranking Member
House Committee on Ways & Means
1236 Longworth House Office Building
Washington, DC 20515

RE: Amendment to Provide a Full Deduction for Administration Costs of Estates and Trusts under IRC Section 67(e)

Dear Chairmen Baucus and Camp, and Ranking Members Hatch and Levin:

The American Institute of Certified Public Accountants (AICPA) is pleased to provide our strong support for what we believe is a bipartisan measure to amend Internal Revenue Code (the Code) section 67(e) to simplify the law and allow estates and nongrantor trusts to fully deduct the cost of complying with fiduciary duties in administering estates and trusts.¹ The current law denies a deduction for the cost of complying with many fiduciary duties to the extent that their aggregate cost does not exceed 2-percent of the taxpayer's adjusted gross income. This is known as the "2-percent floor."

The AICPA is the national professional organization of Certified Public Accountants comprised of approximately 377,000 members. Our members advise clients on federal, state and international tax matters, and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-sized business, as well as America's largest businesses.

By way of background, Congress enacted section 67(a) in 1986 to limit deductions for miscellaneous itemized deductions to those in excess of 2 percent of adjusted gross income (AGI). Congress's purpose was to reduce recordkeeping for numerous small expenditures and eliminate deductions for many, essentially personal expenditures claimed in error.² Because estates and nongrantor trusts³ are taxed in the same manner as individuals, Congress provided an exception to the 2-percent floor in section 67(e) for fiduciary

¹ The AICPA submitted a similar proposal on [September 8, 2008](#) to the 110th Congress.

² [Sen. Rep. No. 99-313](#), 1986-3 C.B. Vol. 3, p. 78; [House Rep. No. 99-426](#), 1986-3 C.B. Vol. 2, p. 109.

³ A nongrantor trust is a trust that is treated as a separate taxable entity from its grantor or beneficiary. By contrast, a grantor trust is one whose grantor or beneficiary is treated as the owner of all or part of the trust property for income tax purposes.

The Honorable Max Baucus
The Honorable Dave Camp
The Honorable Orrin G. Hatch
The Honorable Sander M. Levin
May 2, 2012
Page 2 of 5

administrative costs that would not have been incurred “if the property were not held in such trust or estate.”

Because of the statute’s unusual wording, there have been numerous judicial battles over its meaning. In 2008, the U.S. Supreme Court held in [Knight v. CIR](#), 552 U.S. 181, 128 S. Ct. 782 (2008), that the statute allows a full deduction for “only those costs that it would be uncommon (or unusual, or unlikely) for such a hypothetical individual to incur.” To make that determination, the Court held that the trustee must “predict” whether a hypothetical person with the trust property would have incurred the cost. Unfortunately this interpretation imposes significant uncertainty, complexity, recordkeeping, and enforcement burdens on both the trustee and the government. In short, it raises more questions than it answers.

We have worked together with the American Bankers Association, the American Bar Association, the American College of Estate and Trust Counsel and other groups to provide the Internal Revenue Service (IRS) and Treasury input on [July 27, 2007 proposed regulations](#) section 1.67-4. On September 7, 2011, the IRS withdrew those regulations and issued a replacement set of [proposed regulations](#) section 1.67-4 attempting to implement the Supreme Court’s decision. The proposed regulations require trustees’ fees and other single commission fees to be unbundled and separated between costs that are commonly incurred by individuals and those that are not. The IRS and Treasury have been unsuccessful in drafting regulations that are clear and administrable, without subjecting nearly all administrative costs to the 2-percent floor. Doing so eliminates the exemption under section 67(e). Expressing similar frustration over section 67(e), Chief Justice Roberts commented:

While Congress’s decision to phrase the pertinent inquiry in terms of a prediction about a hypothetical situation inevitably entails some uncertainty, that is no excuse for judicial amendment of the statute.

The solution, in our view, is to amend the statute. We think the proposed amendment below would simplify the statute, would modernize it for the prudent investor rule,⁴ make it easier to administer, and provide a consistent definition of AGI for estates and nongrantor trusts throughout the Internal Revenue Code. We do not think the proposal would encourage individuals to create nongrantor trusts to merely avoid the 2-percent floor. The associated costs of creating such trusts would likely exceed any tax benefit. Creating a separate trust requires giving the money away, not to mention the extra management cost and liability associated with creating a separate legal entity.

⁴ The prudent investor rule requires a trustee to invest trust funds as a prudent investor would for the account of another. Prior to the Uniform Prudent Investor Act of 1992, trustees were only required to follow the prudent man rule, which required the trustee to invest trust funds as he would for himself.

The Honorable Max Baucus
The Honorable Dave Camp
The Honorable Orrin G. Hatch
The Honorable Sander M. Levin
May 2, 2012
Page 3 of 5

As amended, the statute would provide:

67(e). DETERMINATION OF ADJUSTED GROSS INCOME IN CASE OF ESTATES AND TRUSTS. For purposes of this section, 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,~~... shall be treated as allowable in arriving at adjusted gross income.

We support this measure for the following reasons:

- 1. The present statute is overly complex and burdensome.** The trustee must predict whether an ordinary individual with the same property would have incurred the same cost or a portion thereof, under the Supreme Court's reading of the statute. The trustee must then separate his/her fees into the portion an individual would have incurred (subject to the 2-percent floor) and the portion that is fully deductible. The proposed regulations indicate "any reasonable method" is to be used for the determination. Such recordkeeping complexity is contrary to sound tax policy.
- 2. A legislative change would eliminate uncertainty, inconsistencies, and errors arising from the requirement to predict what individuals commonly do.** Because section 67(e) requires the extraordinarily difficult task of predicting whether individuals would commonly incur a particular expense that the trust or estate incurred, it will result in uncertainty, inconsistent treatment from trust to trust, errors of judgment, and potential penalties on both the trustee and tax preparers.
- 3. The present statute requires extensive recordkeeping.** The Supreme Court's interpretation of section 67(e) requires the trustee to keep additional records to determine whether and how its expenses are different from those incurred by hypothetical individuals with the same property. This additional recordkeeping is contrary to Congress's original purpose for section 67, which was to *simplify* recordkeeping and limit individuals from deducting personal expenses (safe deposit box fees, investment magazines, home office expenses, etc.).
- 4. The present statute is out of date.** The present statute was enacted eight years before the [Prudent Investor Act \(1994\)](#) was adopted by nearly every state. The Prudent Investor Act raised the investment standard from the "prudent man" to the more demanding "prudent investor" rule, requiring many trustees to obtain specialized expertise to fulfill their fiduciary duties. Thus, the Internal Revenue Code denies a full deduction for costs incurred to comply with the Act merely because individual investors sometimes incur the same costs.

5. The present statute penalizes compliance with fiduciary duties. The present statute penalizes trustees for incurring costs to carry out their mandatory fiduciary duties. Trustees who hire professional advisors to comply with their duty to invest prudently will be denied some or all of their deductions. However, if they forgo the professional advice, they risk a breach of fiduciary duty. Such tension should not exist between the Internal Revenue Code and other regulatory acts.

6. Trusts are small taxpayers. According to IRS Statistics of Income for 2010, over 96 percent of all trusts report less than \$100,000 of total income, including capital gains.⁵ These trusts are often maintained for minors, disabled individuals, and the elderly. This \$100,000 threshold is significantly below the amount generally used to define “wealthy taxpayers” for whom benefits are limited. The Internal Revenue Code should reflect that estates and trusts are generally small taxpayers burdened with mandatory duties that require extra costs to administer.

7. Cost of compliance does not justify the tax collected. As section 67(e) is presently interpreted, trusts and estates must determine on an item-by-item basis which costs would not customarily be incurred by a hypothetical individual in order to determine the costs not subject to the 2-percent floor. In order to avoid the cost, complexity, and recordkeeping required to determine which costs would not commonly be incurred by a hypothetical individual, many small trusts and estates might simply subject all their costs to the 2-percent floor, forfeiting their right to the full deduction because they cannot justify the compliance cost. Large trusts and estates may decide to incur the extra cost of recordkeeping in order to obtain a full deduction. The additional compliance cost for both the government and fiduciaries will likely be significant compared to the incremental revenue. Sound tax policy should not limit the availability of legitimate tax deductions to only those who can afford the cost to comply.

8. The proposed change is simple. The bill proposes to simply delete the phrase at the end of section 67(e)(1) - “and would not have been incurred if the property were not held in such trust or estate.” Such change would allow a full deduction for all costs “incurred in connection with the administration of the trust or estate.” It would be administrable, fair, and consistent with Congress’s intent to simplify recordkeeping. It would also eliminate the tension between the Prudent Investor Act’s mandate to invest prudently and the Internal Revenue Code’s denial of a full deduction for the costs of complying with the Act.

9. Trustees are already heavily regulated. Trustees are heavily scrutinized on how they invest property entrusted to them compared to individuals who are free to manage

⁵ Table 1. Fiduciary Income Tax Returns, Income Source, Deductions, and Tax Liability, by Tax Status and Size of Total Income, Filing Year 2010, available at <http://www.irs.gov/taxstats/article/0,,id=225290,00.html>.

The Honorable Max Baucus
The Honorable Dave Camp
The Honorable Orrin G. Hatch
The Honorable Sander M. Levin
May 2, 2012
Page 5 of 5

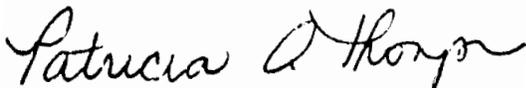
their own property. Trustees must comply with the Uniform Trust Code, the Uniform Prudent Investor Act, the Uniform Principal and Income Act, and numerous other federal and state laws. These laws require them to be loyal and impartial, to diversify, to contain costs, and to consider numerous other circumstances unique to a trust. Trusts and estates were not the original target of section 67(e) when Congress sought to reduce recordkeeping and deductions for personal expenses.

10. The proposed change would provide a single definition of AGI for an estate or trust in the Internal Revenue Code. The Internal Revenue Code contains two different definitions of AGI for an estate or trust. Section 67(e) provides that AGI is determined after deducting costs “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.*” However, section 165(h)(4)(C) provides that AGI is determined after deducting “costs paid or incurred in connection with the administration of the estate or trust.” These two distinctly different definitions of AGI serve no purpose. The Internal Revenue Code should be simplified to provide a single definition of AGI for estates and trusts, which should be the definition contained in section 165(h)(4)(C).

* * * * *

We thank you for the opportunity to present our support for this legislative proposal. Please feel free to contact me at (401) 699-0206, or patt@pgco.com; Frances Schafer, Chair of the AICPA Trust, Estate, and Gift Tax Technical Resource Panel, at fran.schafer@us.gt.com, or (202) 521-1511; or Eileen R. Sherr, AICPA Senior Technical Manager, at (202) 434-9256, or esherr@aicpa.org, to discuss the above comments or if you require any additional information.

Sincerely,



Patricia A. Thompson, CPA
Chair, AICPA Tax Executive Committee