ACTEC Recommendations for 2012-2013 Guidance Priority List (Notice 2012-25)

April 30, 2012

CC:PA:LPD:PR (Notice 2012-25)
Internal Revenue Service
Room 5203
Post Office Box 7604
Ben Franklin Station
Washington, DC 20044
Via Electronic Mail: Notice.Comments@irscounsel.treas.gov

Re: Recommendations for 2012-2013 Guidance Priority List (Notice 2012-25)

Dear Ladies and Gentlemen:

The American College of Trust and Estate Counsel (the "College") is pleased to submit these recommendations pursuant to Notice 2012-25, 2012-15 I.R.B. 789released on March 8, 2012, which invites recommendations for items that should be included on the 2012-2013 Guidance Priority List.

The College is a professional organization of approximately 2,600 lawyers from throughout the United States. Fellows of the College are elected to membership by their peers on the basis of professional reputation and ability in the fields of trusts and estates and on the basis of having made substantial contributions to those fields through lecturing, writing, teaching, and bar activities. Fellows of the College have extensive experience in providing advice to taxpayers on matters of federal taxes, with a focus on estate, gift, and GST tax planning, fiduciary income tax planning, and compliance. The College offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

The recommendations include items in the following categories and, as encouraged by the Notice, we have placed the items under each category in what we believe to be the order of their priority.

EMPLOYEE BENEFITS

1. Guidance identifying the "successor beneficiaries" of a trust who may be disregarded in determining a decedent's designated beneficiary when a nonconduit "see-through" trust is named beneficiary of qualified plan or IRA benefits.

2. Guidance concerning spousal rollovers of qualified plan and IRA benefits when an estate or trust is named beneficiary of a decedent's interest.

GIFTS AND ESTATES AND TRUSTS

1. Guidance under Sections 2001 and 2505 regarding calculation of tax when the unified credit has decreased.

2. Guidance regarding the completion of gifts and includibility in the gross estate in the context of self-settled asset protection trusts.

3. Safe Harbor Guidance concerning the application of the Reciprocal Trust Doctrine.

INTERNATIONAL ISSUES

1. Guidance concerning the coordination of the foreign corporation antideferral rules and Subchapter J.

2. Guidance concerning the application of the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. No. 111-147, 124 Stat. 71 (2010) on reporting and withholding with respect to trusts and their beneficiaries.

If you or your staff would like to discuss the recommendations, please contact Ronald D. Aucutt, Chair of the ACTEC Washington Affairs Committee, at (703) 712-5497, or raucutt@mcguirewoods.com; or Leah Weatherspoon, ACTEC Communications Director, at (202) 688-0271, or lweatherspoon@actec.org.

Respectfully submitted,

Louis A. Mezzullo
President

Enclosure

The American College of Trust and Estate Counsel (ACTEC) Recommendations for the 2012-2013 Guidance Priority List (Notice 2012-25)
April 30, 2012

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INTERNATIONAL ISSUES

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2. **Guidance concerning the application of the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. No. 111-147, 124 Stat. 71 (2010) on reporting and withholding with respect to trusts and their beneficiaries.**

EMPLOYEE BENEFITS

1. **Guidance identifying the "successor beneficiaries" of a trust who may be disregarded in determining a decedent's designated beneficiary when a non-conduit "see-through" trust is named beneficiary of qualified plan or IRA benefits.**

   Reg. §1.401(a)(9)-4, A-5 provides that if a trust is named as beneficiary and certain threshold requirements for a "see-through trust" are satisfied, the beneficiaries of the trust (and not the trust itself) will be treated as having been designated for purposes of determining the minimum required distribution period under Section 401(a)(9). Reg. §1.401(a)(9)-5, A-7 provides that "contingent beneficiaries" of such a trust must be counted among the trust's beneficiaries for purposes of determining the distribution period, but "successor beneficiaries" will be disregarded. The distinction between the two is not articulated in the regulations apart from two examples. From one example (Reg. §1.401(a)(9)-5, A-7, Ex. 2), one may extrapolate that remaindermen of a conduit trust (a trust under which all plan or IRA distributions are required to be paid out currently as opposed to accumulated in the trust) that lasts for the lifetime of the conduit beneficiary will be treated as successor beneficiaries. The second example (Reg. §1.401(a)(9)-5, A-7 Ex. 1,) deals with a non-conduit trust, but is of limited utility since it describes a trust which in the real world would not exist.

   Non-conduit trusts are widely used as estate planning vehicles for time-honored reasons having nothing to do with income tax planning. The lack of guidance on the contingent beneficiary and successor beneficiary concepts since 2002, when the regulations were issued, has complicated standard planning for millions of plan participants and IRA owners and has introduced unnecessary uncertainty. These issues continue after the death of the participant or IRA owner who has named a trust as beneficiary, when a decision needs to be made as to the applicable payout period. The ad hoc process of private letter rulings is an expensive and, for most taxpayers, unfeasible way of obtaining certainty.

   Please see the attached March 27, 2003 ACTEC letter addressed to Marjorie Hoffman, Esq., Senior Technician Reviewer, Employee Benefits & Exempt Organizations, Internal Revenue Service (also transmitted to George Bostick, Esq., Benefits Tax Counsel, Office of Tax Policy at the Department of Treasury by the attached July 1, 2010 ACTEC letter). The 2003 letter provides examples of six non-conduit trusts named as beneficiaries of qualified plan or IRA benefits, suggests which beneficiaries should be identified as successor beneficiaries in each case, discusses the rationale for the results, and emphasizes the need for clear rules to make these determinations. The 2003 letter reviews the "snapshot rule" that has been applied in many private letter rulings and compares that rule to a suggested "life expectancy rule" that might instead be applied to a greater number of non-conduit trust provisions.

   The 2003 letter also proposes for consideration a rule to apply to trusts that defer distributions to a younger beneficiary until a specified age is attained. The proposed rule is contrary to the result reached in certain private letter rulings, but it is supported by strong policy considerations [recognized in the generation-skipping transfer (GST) tax law] and produces a simpler, more understandable method of determining successor beneficiaries in this common form of non-conduit trust. Finally, the 2003 letter discusses instances where a trust beneficiary's estate is the recipient or potential recipient of trust benefits upon the beneficiary's death and the reasons such a circumstance should not prevent the trust beneficiary from being treated as a designated beneficiary.

2. **Guidance concerning spousal rollovers of qualified plan and IRA benefits when an estate or trust is named beneficiary of a decedent's interest.**

   Spousal rollovers of qualified retirement plans and IRAs are allowed under Sections 402(c) and 408(d). More than a hundred private letter rulings have been issued since the late 1980s allowing a spousal rollover when an estate or trust (not the surviving spouse) is named as beneficiary. In the vast majority of these rulings, the spouse as executor, trustee and/or beneficiary may unilaterally effect the rollover, and this appears to be key to the result reached. The preamble to the final Section 401(a)(9) regulations, however, suggests a broader approach, which would permit a surviving spouse who does not unilaterally control distributions from an IRA but who does actually receive a distribution from a decedent's IRA to complete a spousal rollover.

   The basic fact pattern found in the private letter rulings arises frequently. Therefore, we believe that a published ruling is needed. Currently, after the death of a plan participant or IRA owner, the spouse may be obliged to obtain his or her own ruling at considerable cost and inconvenience, either because the plan administrator or IRA sponsor insists on a ruling or simply because the spouse knows that even numerous private letter rulings issued to others may not be relied on. A Revenue Ruling would provide assurance to plan sponsors and guidance to taxpayers as to the circumstances (whether a spouse's unilateral control over the decision to distribute the decedent's interest in the plan or account, the spouse's actual receipt of a distribution, or both) under which a spousal rollover is valid if an estate or trust is named as the beneficiary.

   Please see the attached April 15, 2009 ACTEC letter addressed to Henry S. Schneidermann, Assistant Chief Counsel, Internal Revenue Service (also transmitted to George Bostick, Esq., Benefits Tax Counsel, Office of Tax Policy at the Department of Treasury by the attached July 1, 2010 ACTEC letter). The 2009 letter provides more detail of the issues, requests clarifying guidance, underscores the need for that guidance, and presents a proposed resolution that would avoid the current need for private letter rulings.

GIFTS AND ESTATES AND TRUSTS

1. **Guidance under Sections 2001 and 2505 regarding calculation of tax when the unified credit has decreased.**

There is significant concern about whether there will be a clawback of the unified credit in effect for gift tax purposes in 2004 through 2012 in the event that the credit amount decreases in the future. Allowing a clawback would effectively impose an additional tax on a gift completed in a prior year, a situation that Congress has sought to avoid in the past. H.R. Rep. No. 97-201, 97th Cong., 1st Sess. 156 (1981) (wording of Section 2001(b)(2) was intended "to prevent the change in rates from having a retroactive effect to gifts made prior to" the phase-in of the lower rates); H.R. Rep. No. 94-1380, 94th Cong., 2d Sess. 13 (1976) (the objective of the estate tax calculation was to tax the estate in the proper rate bracket so that "previous taxable gifts only affect the starting point in determining the applicable rate"). Neither the statutory provisions nor existing regulations provides a clear answer as to how the unified credit is to be allowed when the credit amount decreases. The only existing "guidance" on this issue is the forms, instructions and worksheets. The regulations under Sections 2001 and 2505 should be amended to provide clear answers regarding these issues. Given the urgency of this issue (should the credit amount actually decrease for 2013), it would be appropriate to issue a Notice prior to the end of 2012, followed by an update of the Forms 706 and 709 in mid-2013. A more detailed resolution of these issues is discussed below.

Section 2001(b) includes a computation of tentative tax on an estate by adding the amount of the taxable estate and the amount of the adjusted taxable gifts and computing the tax on that sum, then subtracting the amount of gift tax that would have been payable on the adjusted taxable gifts had the rate schedule in effect at the date of death been in effect when the gifts were made. Although Section 2001(b) prescribes the rates to be applied in this computation, it is silent on how to apply the unified credit to determine the gift tax payable in the year of the gift when the credit amount in the year of death differs from the credit amount available in the years of the gifts. Section 2001(g) is helpful, but it will sunset at the end of 2012. Current regulations, many of which were promulgated in 1958, also offer no guidance.

New regulations under Section 2001 could provide that in computing the amount of gift tax payable on the adjusted taxable gifts, the unified credit to be taken into account shall be the lesser of the unified credit in the year of the death and, with respect to each gift, the credit in effect when the gift was actually made. By crediting the estate with the tax that would have been paid but for the increased unified credit available in the year of the gift, this provision would give taxpayers the benefit of the larger credit amount in effect in the year of the gift in the event the credit amount decreases between the year of the gift and the year of death. If the credit in the year of death were used in this circumstance, the estate would effectively be paying estate tax on the portion of the decedent's lifetime gifts covered by the larger credit. In the case of an increasing credit amount, the result would be the same as that produced by the current forms and instructions, which instruct taxpayers to use the credit in effect in the year of the gift. These instructions, however, are not sufficient because the instructions were written when the credit in the year of death could not have been less than the credit in the year of the gift, as the amount of the credit had increased but never decreased from year to year.

Similarly, the gift tax regulations should be amended to account for changes in the unified credit as applicable to lifetime gifts. Section 2505 provides that the applicable credit amount in effect under Section 2010(c) for the calendar year shall be reduced by the sum of the amounts allowable as a credit to the individual for gifts in preceding calendar periods. The regulations should clarify that in calculating this difference the amount allowable as a credit in any preceding calendar period cannot be less than zero. For example, if the current year's applicable exclusion amount is $1,000,000 (so that the unified credit for the current year equals the tax on $1 million at the current year's rates) and the taxpayer's only prior taxable gift was a gift of $5,000,000 in a year when the applicable exclusion amount was $5,000,000 (so that the unified credit used would clearly exceed the credit available in the current year), the remaining unified credit available should be zero, not a negative number attributable to the negative $4,000,000 applicable exclusion amount.

2. **Guidance regarding the completion of gifts and includibility in the gross estate in the context of self-settled asset protection trusts.**

In an environment of increasing concern that wealth can attract claims and create risks, it is becoming more common for grantors to create trusts in which, for their lives, they themselves (and sometimes others too) have an interest, often in a trustee's discretion. The trust is designed to protect the trust assets from both opportunistic claims and the unwise decisions of grantors themselves. Because the amount of wealth involved in such self-settled trusts is often substantial, it is important for those grantors to know the gift and estate tax consequences – that is, whether and to what extent the transfer will be complete enough to be a taxable gift for federal gift tax purposes and whether and to what extent the value of the trust property will be included in the grantor's gross estate for federal estate tax purposes. Of those two issues, the completed gift issue is the most important, because it has immediate impact.

The principle typically applied to determine whether a transfer is a completed gift is in Reg. §25.2511-2(b):

> As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

The completed gift issue has recently been spotlighted by the disclosure of an Office of Chief Counsel Internal Revenue Service Memorandum dated September 28, 2011 (opened to public inspection on February 24, 2012, asCCA 201208026). Quoting the above regulation, CCA 201208026 concludes that Donors had made completed gifts to a Trust (albeit not a "selfsettled" trust from which the Donors themselves could receive distributions). CCA 201208026 has attracted attention among practitioners because it finds a completed gift despite the Donors' testamentary powers over the disposition of the trust property upon their deaths, powers that estate planners have frequently used specifically to prevent a transfer from being a completed gift. This in turn has raised questions about the continued application of the published guidance on which those practitioners have relied, including in the context of selfsettled trusts.

As an example, Rev. Rul. 62-13, 1962 C.B. 180, ruled a transfer in trust incomplete because trustees had discretion to pay income and/or principal to the grantor and others during the grantor's life and there was therefore "no assurance that anything of value would ever pass to the remaindermen," even though the grantor retained no power to direct the disposition of the remainder. Thus, CCA 201208026 presents the anomaly that its Donors with a power of appointment over the trust property at death were left with "no power to change [the trust property's] disposition," while the grantor in Rev. Rul. 62-13 who retained no power had not "parted with dominion and control." ButCCA 201208026 does not cite Rev. Rul. 62-13 (or Rev. Rul. 77-378, 1977-2 C.B. 347, which "clarified" it).

As another example, CCA 201208026 rests its holding on the fact that the Donors' "limited power to appoint so much of [the trust property] as would still be in the Trust at his or her death" would be reduced or eliminated – in effect terminated – by the trustee's discretionary distributions during the Donors' lives. Reg. §25.2511-2(f) specifically addresses the "termination" of such a power, including termination by the "receipt of income or of other enjoyment of the transferred property by the transferee or by the beneficiary (other than by the donor himself)," which "operates to free such income or other enjoyment from the power." But CCA 201208026 does not cite Reg. §25.2511-2(f).

We appreciate that CCA 201208026 is necessarily a part of a larger file, that it is addressed to Area Counsel and thus possibly written in contemplation of litigation (or at least serious pursuit of issues in audit), and that it recites that it "may contain privileged information" (although no redaction other than identifying details, including identification of the jurisdiction, is apparent), and for all those reasons it may not tell the whole story. We also appreciate thatCCA 201208026 may not be used or cited as precedent (and it so recites). Nevertheless, such documents, when made available for public inspection, are used by practitioners to guide their own best practices and assist them in advising clients. Thus, balanced (and citable) guidance that seeks to resolve questions rather than to pursue a litigation position would be desirable and would foster uniform treatment and compliance. As we have seen in other contexts (such as Rev. Rul. 81-51, 1981-1 C.B. 458, and Rev. Rul. 2004-64, 2004-2 C.B. 7), such guidance could and perhaps should address the extent to which it will be applied prospectively under Section 7805(b)(8).

3. **Safe Harbor Guidance concerning the application of the Reciprocal Trust Doctrine.**

Since 1940, the courts have recognized there were circumstances when trusts can be so interrelated that the economic positions of the persons who created the trusts have not changed enough to honor the separate trusts for certain tax purposes. As a result, it is possible that trusts created at about the same time may be "uncrossed" and one or more of the retained power provisions (Sections 2036-2038) applied to cause a portion or all of the value of a trust to be included in the settlor's gross estate. This result can obtain even though the settlor was not a beneficiary of that included trust and did not retain a power with respect to that trust which would cause such inclusion absent the existence of the so-called reciprocal trust. This has come to be known as the "Reciprocal Trust Doctrine."

Even though the Doctrine was recognized and applied by the United States Supreme Court in United States v. Grace (395 U.S. 316 (1969)) the federal courts and the Internal Revenue Service have been required to define and apply the doctrine in a variety of settings with varying results. See, for example, Estate of Bischoff (69 T.C. 32 (1977)), Estate of Herbert Levy (T.C. Memo 1983-453 (1983)), Estate of Green v. United States (68 F. 3d 151 (6th Cir. 1995)), and Private Letter Rulings 199643013 and 200426008. Taxpayers and their advisors frequently are faced with a planning situation where both spouses are planning to engage in an arrangement concerning the wealth of the spouses and their family that is best structured using two trusts, which ideally might be identical in terms but for the identity of the settlors. This is most common when spouses are designing mirror image arrangements for themselves and younger family members. Skilled practitioners are able to create degrees of difference which should decrease the possibility of uncrossing such trusts. However, in the absence of a definitive set of rules addressing this issue, taxpayers and their advisors are left to speculate, which can lead to extreme variations in plans solely to assure that one does not run afoul of the Doctrine.

While it may not be necessary to address the full range of variations that should result in trusts that need not be uncrossed, it should be possible to create greater clarity by acknowledging a set of safe harbors such as the existence of separate trustees (or co-trustees when the settlors have been named as fiduciaries) or differences in the powers granted to the spouses, both of which would make it possible to have trusts with a common purpose without requiring some of the differentiation and distortion commonly applied currently to avoid the application of the Doctrine.

INTERNATIONAL ISSUES

1. **Guidance concerning the coordination of the foreign corporation anti-deferral rules and Subchapter J.**

ACTEC submitted comments to representatives of the Department of the Treasury on June 23, 2010. A copy is attached. The corporate anti-deferral rules applicable to controlled foreign corporations ("CFCs") and passive foreign investment companies ("PFICs") and the accumulation distribution rules applicable to trusts serve the same purpose – preventing the use of foreign entities to defer payment of tax or imposing an interest charge if tax payment is deferred. Proposed regulations on the corporate anti-deferral rules for passive foreign investment companies were issued on April 1, 1992, and have not been finalized. The preamble notes the need to coordinate the accumulation distribution rules of Subchapter J and the PFIC tax regime. We agree, but there has been no further published guidance in twenty years. The need for guidance is increased by the penalties imposed by new Section 1298(f) for a beneficiary's failure to report indirect ownership of PFIC shares. ACTEC comments suggested a set of rules that would better coordinate the overlapping rules with the objective that tax would be owed at the time a person received distributions (and not before) but the interest charge on delayed payment of tax would be preserved.

The possible issues include:

a. Whether beneficiaries should be deemed to indirectly own CFCs and PFICs through a discretionary non-grantor trust and if so, how the allocation of ownership will be made and how adjustments will be made to avoid double tax when income imputed to a beneficiary is later distributed to that person or another person or when the trust disposes of shares.

b. Whether, instead of imputing income to beneficiaries, beneficiaries should be taxed when they receive distributions (as under Subchapter J) but the interest charge under the accumulation distribution rules would be modified to treat the trust as having accrued income at the time the income accrued to the CFC or PFIC owned by the trust.

c. Clarification of indirect ownership of PFICs through US entities.

2. **Guidance concerning the application of the Foreign Account Tax Compliance Act ("FATCA") provisions of the Hiring Incentives to Restore Employment ("HIRE") Act (P.L. No. 111-147, 124 Stat. 71 (2010) on reporting and withholding with respect to trusts and their beneficiaries.**

ACTEC submitted comments to representatives of the Department of the Treasury on January 7, 2011, concerning the application of FATCA to trusts and their beneficiaries. A copy is attached. Since that time, proposed and temporary regulations were issued under Section 6038D, a draft Form 8938 was issued, and proposed regulations were issued concerning Sections 1471-1474. ACTEC expects to submit comments on the proposed regulations.

The possible issues include:

a. How to determine when a beneficiary of a trust and/or an estate has a reporting obligation, particularly in the case of a discretionary trust or a future interest.
b. How to determine the value and/or percentage of a beneficiary's interest in a trust and/or an estate, particularly in the case of a discretionary trust or a future interest.
c. How to determine whether a foreign entity has a "substantial US owner."
d. Whether a trust should be classified as a foreign financial institution ("FFI") or a non-financial foreign institution ("NFFE").
e. How to determine the value and/or percentage of a beneficiary's indirect interest in an entity owned by a trust, particularly a discretionary trust.
f. Whether any beneficiary of a trust other than the owner of a grantor trust has a reporting obligation under Section 6038D or has to be identified in an owners report.

g. How to determine who is the "payee" for purposes of withholding underSection 1471 when payment is made to a trust (i.e., is payment made to a trustee on behalf of a trust or to a trust as an entity), a disregarded entity, a flow-through entity, an intermediary, a participating FFI, a non-participating FFI, or an NFFE.
h. Verification procedures for determining that a trust has no substantial US owners and whether foreign owners have to be identified in an owners report.
i. Clarification of the obligation of a US beneficiary to report under Section 6038D if the beneficiary's interest is valued at zero under applicable regulations.
j. How to avoid duplicative reporting.
k. Clarification and simplification of reporting under new Section 1298(f).
l. Clarification of reporting obligations of a participating FFI in the case of a trust so that "separate accounts" of beneficiaries (which do not exist) are not required to be reported.
m. Clarification of reporting obligations of "owner-documented" FFIs.
n. Clarification of affiliations that are prohibited for owner-documented FFIs.
o. Guidance concerning an election by a foreign trustee to file US information returns.