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The American College of Trust and Estate Counsel

Please Address Reply to:

Executive Director
DEBORAH O. MCKINNON

April 28, 2015

Internal Revenue Service
CC:PA:LPD:PR (Notice 2015-27)
Room 5203
Post Office Box 7604
Ben Franklin Station
Washington, D.C. 20044

Via Electronic Mail: Notice.Comments@irscounsel.treas.gov

Re: Recommendations for 2015-2016 Guidance Priority Plan (Notice 2015-27)

Dear Ladies and Gentlemen,

The American College of Trust and Estate Counsel ("ACTEC") is pleased to submit recommendations pursuant to Notice 2015-27, I.R.B. 2015-13, released March 16, 2015, which invites recommendations for items that should be included on the 2015-2016 Guidance Priority Plan.

ACTEC is a professional organization of approximately 2,600 lawyers from throughout the United States. Fellows of ACTEC 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 ACTEC 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. ACTEC offers technical comments about the law and its effective administration, but does not take positions on matters of policy or political objectives.

ACTEC recommends the same items that ACTEC recommended last year, with one modification and one addition, each described below. A copy of our 2014 submission is enclosed.

Last year, ACTEC recommended that guidance be issued 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. (Please see Item #3 under "International Issues" of our 2014 submission). Since then, final regulations have been issued (See T.D. 9610, 2013-15 I.R.B. 765 (2013); T.D. 9657, 2014-13 I.R.B. 687 (2014)), and additional guidance has been forthcoming in the form of new Intergovernmental Agreements ("IGA"s) with many other countries ("FATCA Partners"). Several FATCA Partners have issued Guidance Notes to explain the provisions of the IGA. Although the final regulations and Guidance Notes have been extremely helpful, some issues remain. Some issues are (i) whether a person's future interest in a trust is considered to be a mandatory beneficial interest for purposes of FATCA reporting; (ii) whether a private trust company and a trust managed by a private trust company are foreign financial institutions; and (iii) whether a trust managed by an individual trustee becomes a foreign financial institution if some of the trust funds are invested in one or more separate investment funds that are financial institutions (such as a mutual fund). These issues are discussed below at item #1 and fall under the category of "International Issues."

The additional recommendation is to clarify whether the marital deduction will be available under the "safe harbor" rule in Rev. Rul. 2006-26, 2006-1 C.B. 939, for retirement plans that designate a qualified terminable interest property trust ("QTIP Trust") as the beneficiary in states that have adopted the 2008 revisions to §409 of the Uniform Principal and Income Act ("UPIA"). This issue is discussed below at item #2 and falls under the category of "Gifts and Estates and Trusts."

1. **International Issues: Clarification of FATCA reporting rules.**

    a. Who is a "beneficiary" for purposes of FATCA?

       For purposes of FATCA, a beneficiary means a beneficiary who has a mandatory distribution right and a discretionary beneficiary if and to the extent such beneficiary actually receives a distribution. Treas. Reg. §1.1471-5(b)(3)(iii)(B). A person whose interest is wholly discretionary and who does not actually receive a distribution is not a beneficiary. Treas. Reg. §1.1471-5(b)(3)(iii)(B)(3). However, the regulations do not specifically address the treatment of a person who has a mandatory future interest in the trust, whether vested or contingent. For example, suppose the trust instrument says that income should be distributed to A for life and then to B for life and then to C if C is then living. Do the interests of B and/or C have to be reported?

       I.R.C. §6038D(a) requires U.S. taxpayers with specified foreign financial assets (including certain interests in foreign entities) to report these investments on an information return (Form 8938) when the aggregate value of the investments exceeds $50,000. A U.S. taxpayer's interest in a foreign trust is not considered to be a specified foreign financial asset for these purposes unless he or she knows or has reason to know (based on readily accessible information) of the interest. Treas. Reg. §§1.6038D-2(b)(4)(iv), 1.6038D-3(c). Receipt of a distribution from the foreign trust constitutes actual knowledge for this purpose. Treas. Reg.

§1.6038D-3(c). The maximum value of a beneficiary's interest in a foreign trust (*i.e.*, the value required to be reported on Form 8938) equals the sum of the amount actually received in the taxable year plus the present value of a mandatory right to receive a distribution. Treas. Reg. §§1.6038D-5(f)(2). The regulations do not distinguish between reporting obligations of taxpayers who have mandatory present interests versus those who have mandatory future interests in foreign trusts.

We suggest that future interests be ignored for FATCA reporting purposes because reporting is not necessary to protect the right to collect taxes. A beneficiary of a future interest is not required to pay income tax and should not be required to file information returns.

This suggestion is consistent with the FBAR regulations, which also disregard future interests. See 31 C.F.R. §1010.350(e)(2)(iv) (defining "financial interest" to include "[a] trust in which the United States person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income.")

We recommend that the FATCA regulations be amended to address future interests in the same manner that the FBAR regulations do, by adding specific language to Treas. Reg. §1.1471-5(b)(3)(iii)(B) saying that: "A future interest is not an equity interest in a trust for these purposes." We recommend adding specific language to Treas. Reg. §1.6038D-3(c) saying that: "A future interest in a foreign trust is not a specified foreign financial asset of a specified person."

b. Private trust companies and trusts managed by private trust companies should not be treated as financial institutions for purposes of FATCA because they are not engaged in a trade or business with the general public and therefore function more like an individual trustee than an institutional trustee.

We note that in at least one Guidance Note (for Cayman Islands) the conclusion is reached that a private trust company that is not "doing business" in the Cayman Islands is not a financial institution. Guidance Notes on the International Tax Compliance Requirements of the Intergovernmental Agreements between the Cayman Islands and the United States of America and the United Kingdom, §6.14, U.S.-Cayman Is.-U.K., Dec. 15, 2014.

We suggest that Treas. Reg. §1.1471-5(e)(4)(i) be amended to provide that "A private trust company that is not engaged in the trade or business of providing services to the general public is not a financial institution, and trusts managed by such a private trust company are not, for that reason alone, treated as investment entities under (e)(4)(i)(B) of this section or as financial institutions under (e)(1)(iii) of this section."

c. Trusts managed by individual trustees are not financial institutions. Treas. Reg. §§1.1471-5(e)(4)(i)(B), 1.1471-5(e)(4)(v), Example (5). However, if a trust with an individual trustee engages a financial institution to manage investments on a discretionary basis, then the trust may be a financial institution. Treas. Reg. §§1.1471-5(e)(4)(i)(B), 1.1471-5(e)(4)(v), Example (6).

   The regulations are not clear whether a trust becomes a financial institution if the individual trustee invests some or all of the trust funds in one or more pooled investment vehicles, such as mutual funds. It is very typical for individual trustees to invest trust funds in mutual funds. It does not seem to be the intent of the regulations to make such a trust a financial institution because in this case the individual trustee remains responsible for investments, and monitoring the performance of a fund seems to be the same as monitoring he performance of individual stocks and bonds, but clarification of this point would be helpful so that the filing status of a trust could be clear.

2. **Gifts and Estates and Trusts: Clarification that QTIP and general power of appointment marital trusts holding retirement benefits in states that have adopted the 2008 revisions to the Uniform Principal and Income Act ("UPIA") approved by the Uniform Law Commission satisfy the safe harbor for the estate tax marital deduction.**

   Rev. Rul. 2006-26, 2006-1 C.B. 939, considered whether the "all income" requirement of I.R.C. §2056 and Treas. Reg. §§20.2056(b)-5(f)(1) and 20.2056(b)-7(d)(2) was satisfied in three fact situations. In each, a marital deduction trust held an IRA or a defined contribution plan. In the fact pattern, assuming that a QTIP marital trust was governed by the law of a state that had adopted the 1997 version of the UPIA, the ruling concluded that the trust may not meet the "all income" requirement if: (1) the trust language did not require the trustee to distribute to the spouse the greater of all the income of the IRA (considered as if the IRA were a separate trust) or the annual required minimum distribution under I.R.C. §408(a)(6), and (2) the governing law included §§409(c) and (d) of the 1997 version of the UPIA. This was because UPIA §409(c) provided that a required minimum distribution from the IRA was allocated 10 percent to income and 90 percent to principal, whereas the view of the Service was that such an apportionment between principal and income was not based on the total return of the IRA and did not reflect a reasonable apportionment of the total return between income and remainder beneficiaries. If the trust language did not require the distribution of at least the income of the IRA when the spouse exercised the spouse's right to direct a withdrawal and UPIA §409(c) applied, the "all income" requirement may not be satisfied, according to the ruling.

Although §409(d) of UPIA 1997 states that a trustee must allocate a larger portion of any distribution to income to the extent that doing so is necessary to qualify for the marital deduction, the Service in Rev. Rul. 2006-26 stated that this provision was ineffective to reform an instrument for tax purposes, analogizing the statute to a savings clause in a document that would be ineffective to reform the document for federal tax purposes.

The ruling set forth a "safe harbor" that would apply if a QTIP election were made over both the trust and the IRA or retirement plan and the spouse had the power exercisable annually to compel the trustee to withdraw the income earned on the IRA or retirement plan and to distribute that income and all income earned on the other trust assets to the spouse.

The ruling concluded that marital trusts governed by §§409(c) and (d) of UPIA 1997 could not qualify for the safe harbor.

The Uniform Law Commission considered Rev. Rul. 2006-26 and made the changes discussed below to permit trusts governed by the 2008 version of the UPIA to qualify for the safe harbor. A copy of §409 of the 2008 version of the UPIA with the official comments of the Uniform Law Commission is enclosed. Both ACTEC and the American Bar Association's Real Property, Trust & Estate Law Section endorsed the changes before the Uniform Law Commission approved these changes.

The 2008 UPIA §409 retains a 90/10 allocation for trusts other than QTIP and general power of appointment marital trusts. However, for trusts intended to qualify for the estate tax marital deduction, the trustee is required to separately determine the income of each "separate fund" in such a trust for each accounting period. Separate funds include annuities, IRAs, pensions, profit sharing and bonus stock funds and stock ownership plans.

All distributions received by a trust from such a separate fund are considered income until the income determined in this manner is reached. Distributions in excess of that amount are considered principal.

If the distributions are less than this amount, the 2008 UPIA §409 states that the spouse may require that the trustee allocate principal from a source other than the separate fund to income, to make up the difference.

Subsection (f) of the 2008 UPIA §409 requires that a trustee demand that the person administering the fund distribute the internal income to the trust upon the request of the surviving spouse.

Under UPIA 2008, if a trustee cannot determine the income of a separate fund, the trustee is to apply a percentage between 3 and 5 percent, depending on the adopting state's choice, to the fund's value to determine the income.

Further, if the value of the separate fund cannot be determined, the trustee is to compute an income equivalent by multiplying the I.R.C. §7520 rate by the present value of the payments, based on the §7520 rate.

The Service has published no new guidance on this issue since the 2008 revisions to the UPIA. A new revenue ruling replacing Rev. Rul. 2006-26 and concluding that the "all income" requirement is satisfied by marital trusts governed by the laws of a state adopting §409 of UPIA 2008 is needed. The fact pattern is an extremely common one affecting a large number of taxpayers. Rather than putting taxpayers to the difficulty and expense of requesting private letter rulings and consuming the time of the National Office, we believe that the Service should provide a revenue ruling concluding that marital trusts governed by UPIA 2008 that hold IRAs or defined contribution plan benefits satisfy the "all income" requirement. This guidance would not involve changes to the Treasury regulations.

If you or your staff would like to discuss the recommendations, please contact Ellen Harrison, Chair of the ACTEC Washington Affairs Committee, at (202) 663-8316, or ellen.harrison@pillsburylaw.com; or Leah Weatherspoon, ACTEC Communications Director, at (202) 688-0271, or lweatherspoon@actec.org.

Respectfully submitted,

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President

Enclosures