2025 Supplement

to

Federal Income Taxation of Trusts and Estates:

Cases, Problems, and Materials

(Fourth Edition)

Mark L. Ascher

Robert T. Danforth

PREFACE

This supplement deals with developments we would have included in the casebook, had it gone to press in January 2025.

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

Mark L. Ascher
Austin, Texas

Robert T. Danforth
Lexington, Virginia

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Page 5. At the end of the page, delete the last full sentence and the last citation, due to the repeal of section 1(j)(4).

Page 30. At the end of note 1, add:

In *Rost v. United States*, 44 F.4th 294 (5th Cir. 2022), the court held that a Liechtenstein *Stiftung* created to provide education, training, support, and maintenance for the settlor and his children was a trust for purposes of the foreign trust reporting requirements. Among other things, the court relied on the entity's "familial purpose, lack of business objective, and bar on commercial activity." *Id*. at 302.

In *Fairbank v. Commissioner*, T.C. Memo. 2023-19 (Feb. 23, 2023), the court held that a Liechtenstein *Anstalt* was also a trust for purposes of the foreign trust reporting requirements. The court relied on the entity's close resemblance to "a typical trust" and the fact that nothing in the record indicated that the entity had any business associates or that it conducted any business. The court distinguished I.R.S. Chief Couns. Att'y Memo. 2009-012 (Oct. 7, 2009), which concluded that Liechtenstein Anstalts "generally are not properly treated as trusts . . . because, in most situations, their primary purpose is to actively carry on business activities."

Page 38. Replace the Internal Revenue Code assignment with:

Internal Revenue Code:

Sections 164(a), (b)(6); 265(a)(1); 275(a)(1)

Page 89. At the end of the Illustrative Material, add:

In T.D. 9918, 2020-45 I.R.B. 979, the Treasury amended Treas. Reg. § 1.67-4 to make clear that section 67(g) does not apply to expenses described in either section 67(e)(1) or section 67(e)(2). Section 67(g) does, however, apply to any expense described in section 67(b) that is or would be "commonly or customarily" incurred by "a hypothetical individual holding the same property." In other words, section 67(g) suspends, and thus disallows in its entirety, any expense that before 2018 would have been subject to the 2-percent floor. *See generally* Boyle & Blattmachr, *The Tax Act of 2017 Impacts Itemized Deductions and the Pass-Through of Excess Deductions*, Prob. Prac. Rep., Feb. 2018, at 1; Peterson et al., *Deductibility of Trust Expenses Under the Tax Cuts and Jobs Act,* Tr. & Est., May 2018, at 38.

Page 104, note 4. Rev. Proc. 2018-3 (cited in the first paragraph) has been superseded. Rev. Proc. 2025-3, 2025-1 I.R.B. 142, 147, is to identical effect.

Page 187. At the end of section (d) of note 1, add:

In Notice 2018-37, 2018-18 I.R.B. 521, the Service announced its intention to issue regulations clarifying the application of the effective date provisions concerning the repeal of section 682. The Service indicated that the regulations will provide that section 682 will continue to apply as to trust income payable to a former spouse who was divorced or legally separated under a divorce or separation instrument executed on or before December 31, 2018, unless the instrument is modified after that date to provide that the changes of the 2017 Act apply.

Page 207. Add to the second Illustrative Material entry:

This material is based on a problem that appeared in Professor Schmolka's teaching materials for this course at the N.Y.U. graduate tax program in the early 1980's.

Our analysis assumes that no portion of the trustee's fee is attributable to investment advice. Under the regulations, therefore, none of the $9,000 that remains after the application of section 265 is subject to section 67. In the absence of this assumption, the portion of the fee attributable to investment advice would, of course, be subject to section 67.

During the period 2018 to 2025, when section 67(g) suspends *all* miscellaneous itemized deductions, including *all* those for investment advice, it is arguable that the net tax-exempt interest in the hands of the beneficiaries should be $9,000, rather than $8,000. Section 643(a)(5) requires reduction of tax-exempt interest by only those amounts that "would be deductible in respect of disbursements allocable to such interest but for the provisions of section 265." Under section 67(g), the $1,000 expense for investment advice directly allocable to the production of tax-exempt interest would not be deductible.

Page 260, note 3. Rev. Proc. 2018-3 (cited in the first paragraph) has been superseded. Rev. Proc. 2025-3, 2025-1 I.R.B. 142, 147, is to identical effect.

Page 273. Replace note 2 with:

2. In T.D. 9918, 2020-45 I.R.B. 979, the Treasury amended the regulations to clarify the effect of section 67 on a beneficiary's ability to deduct various expenses upon termination of a trust or estate. As amended, Treas. Reg. § 1.642(h)-2(b)(1), now acknowledges that each deduction that passes through to a beneficiary under section 642(h)(2) "retains, in the hands of the beneficiary, its character (specifically, as allowable in arriving at adjusted gross income, as a non-miscellaneous itemized deduction, or as a miscellaneous itemized deduction) while in the estate or trust." *See generally* Boyle & Blattmachr, *The Tax Act of 2017 Impacts Itemized Deductions and the Pass-Through of Excess Deductions,* Prob. Prac. Rep., Feb. 2018, at 1.

Page 273, note 4. *Harrell v. Commissioner* has been affirmed. 765 Fed. Appx. 501 (2d Cir. 2019).

Page 315. At the end of the last full paragraph, add:

Since June 1, 2023, Table S has reflected data from the 2010 census. Treas. Reg. §20.2031-7(d)(7) no longer reproduces the table but refers to it as being available electronically via the IRS website.

Page 348. Replace the last paragraph of the Illustrative Material with:

In Rev. Rul. 2023-2, 2023-16 I.R.B. 658, the Service ruled that section 1014 does not provide a date-of-death value basis for trust assets that are not includible in the grantor's gross estate, even if Subpart E has treated the grantor as their owner during the grantor's lifetime.

Page 397. After note 10, add:

11. *Deduction for qualified business income.* For taxable years 2018 to 2025, trusts and estates can qualify for a deduction under §199A on account of their "qualified business income." I.R.C. §199A(a), (f)(1)(B). But when Subpart E treats the grantor of a trust as owner of part or all of the trust, the grantor computes the grantor's own deduction under §199A as if the grantor "directly conducted the activities of the trust" with respect to the portion the grantor is treated as owning. Treas. Reg. §1.199A-6(d)(2).

Page 410. At the end of the second-last paragraph, add:

As to a loss supposedly incurred upon a transfer of property to a grantor trust, see *Sage v. Commissioner*, 154 T.C. 270 (2020).

Page 411. In line 5, at the beginning of the chain citation, add:

Anderson, *Resolving Unfairness in a Fair Way: How the Grantor Trust Rules Should be Reformed*, 49 ACTEC L.J. 167 (2024); Ascher & Soled, *Updating, Improving, and Simplifying the Grantor Trust Rules*, 182 Tax Notes Fed. 461 (Jan. 15, 2024); Anderson, Note, *Resolving Unfairness in a Fair Way: How the Grantor Trust Rules Should Be Reformed*, 48 BYU L. Rev. 2311 (2023);

Page 413. Replace the Regulation assignment with:

Regulations:

Sections 1.641(a)-0(c), 1.643(f)-1

Page 440. Before the second-last paragraph of note 1, add:

In 2019, thirty-five years after enactment of section 643(f), the government issued Treas. Reg. § 1.643(f)-1, which, unfortunately, does little more than restate the words of the statute.

Page 448. In the fifth-last line of the page, before the reference to *Tarpo v. Commissioner,* add:

Aldridge v. Commissioner, T.C. Memo. 2024-24 (Feb. 21, 2024);

Page 450. After note 8, add:

9. In Chief Couns. Memo. AM 2023-006 (Aug. 9, 2023), the I.R.S. addresses certain outlandish claims allegedly made by promoters of yet another "marketed trust structure." The main claim seems to be that purchase and use of certain trust forms permits liquidation of appreciated assets without subjecting anyone, including the grantor, the trust, and all its beneficiaries, to taxation on the gains. The basis of this claim, cloaked in a pretense of erudition, seems to be that, because section 643 generally excludes capital gains from DNI, it also generally keeps them out of the trust's taxable income. This, however, betrays a horrible misunderstanding of even the most basic principles of Subchapter J. It is true that excluding capital gains from DNI absolves the beneficiaries of any *direct* liability for taxation on them. But excluding gains from DNI does not also exclude them from the trust's taxable income. DNI is a derivative of the trust's taxable income. The reverse proposition is necessarily false. The trust's taxable income is independent of DNI, except insofar as DNI sizes the distribution deduction to which the trust may or may not be entitled under section 651 or 661. Thus, the trust ordinarily remains liable for any income taxes generated by capital gains.

Page 483. In the second line of note 1, before the reference to Rev. Rul. 70-467, add:

Hitchman v. Commissioner, T.C. Summ. Op. 2033-18 (May 2, 2023) (in hands of son who inherited and redeemed father's United States savings bond, all unreported increment in value was income in respect of decedent);

Page 568. Replace the second paragraph of note 2 with:

Section 67(b)(7) excepts the section 691(c) deduction from the operation of section 67.

Page 568, note 3. *Harrell v. Commissioner* has been affirmed. 765 Fed. Appx. 501 (2d Cir. 2019).

Page 568. At the end of note 3, add:

Though an estate tax return has been filed, there is similarly no deduction if the items of income in respect of a decedent did not generate an estate tax. *See Schermer v. Commissioner,* 117 T.C.M. (CCH) 1136 (2019).