

RECENT DEVELOPMENTS

TAX DEDUCTION FOR INVESTMENT ADVISOR FEES

The Federal Court of Appeals (*Scott v. U.S.*, 4th Circuit 2003) held that trust investment advisor fees were miscellaneous itemized deductions subject to deductibility only in excess of 2% of adjusted gross income of the trust under IRC 67(a). In this case, the decedent, who died in 1944, had created a trust for the benefit of grandchildren with a value of approximately \$25 million during 1996 and 1997. During those years, the trust incurred investment advisor fees of \$107,055 and \$119,943. On the income tax returns, the trust fully deducted the fees, and the IRS determined a deficiency.

The trustees of the trust were attorneys who testified that they lacked expertise in investing large sums of money and that they would not have served without outside investment advice. The court affirmed the lower court decision in favor of the IRS, and held that the 2% miscellaneous itemized deduction floor does not apply to a "deduction 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" (emphasis added). In other words, the court held that trust-related administrative expenses are subject to the 2% floor, if they constitute expenses commonly incurred by individual taxpayers.

Because investment adviser fees are commonly incurred outside the context of trust administration, they are subject to the 2% floor under IRC 67(a). Other costs ordinarily incurred by trusts, such as fees paid to trustees, expenses associated with accountings and costs of preparing and filing fiduciary income tax returns, are not ordinarily incurred by individuals, and are fully deductible.

At this time, there is a split of opinion on this issue in the federal circuits, and the issue remains unresolved in the 9th Circuit which includes California.

TRUSTEE RELIEF OF LIABILITY

Effective January 1, 2004, A.B. 1705 added 16004.5 to the Probate Code. The new statute precludes a trustee from requesting relief from liability as a condition for making a distribution or payment to, or for the benefit of, a beneficiary, if the distribution of payment is required by the trust instrument. The statute further provides that it may not be construed as affecting the trustee's right to:

1. Maintain a reserve for reasonably anticipated expenses, including, but not limited to, taxes, debts, trustee and accounting fees, and costs and expenses of administration;
2. Seek a voluntary release or discharge of a trustee's liability from the beneficiary;
3. Require indemnification against a claim by a person or entity other than a beneficiary receiving a distribution, which may reasonably arise as a result of a distribution;
4. Withhold any portion of an otherwise required distribution that is reasonably in dispute; or
5. Seek court or beneficiary approval of an accounting of trust activities. Because the preclusion in 16004.5 is limited to distributions which are "required by the trust instrument," purely discretionary distributions can be made contingent upon the execution of a release of liability.

ACCESS TO HEALTH INFORMATION UNDER HIPAA

The final rules regarding the use and disclosure of “protected health information” issued by the federal Department of Health and Human Services (HHS) took effect on June 14, 2003. These rules provide patients with access to their medical records and more control over how their personal health information is used and disclosed.

HHS issued the patient privacy protections as part of the Health Insurance Portability and Accountability Act of 1996 (HIPAA). Most health care providers were required to comply with these standards beginning April 14, 2003. The regulations protect medical records and all other individually identifiable health information in all written and electronic forms. Of specific importance to fiduciaries, health information generally may not be used for purposes not related to health care, and patients must sign a specific authorization before a covered medical services provider can release medical information to a life insurer, a bank, a marketing firm or other business for purposes not related to the patient’s health care. Substantial civil and criminal penalties may be imposed for misuse of personal health information in violation of the rules.

Accordingly, should a fiduciary need access to protected health information in order to discharge its fiduciary responsibilities, an explicit written authorization for disclosure by the patient will be required. As an example, administration of a sprinkling trust for the benefit of a disabled or seriously ill beneficiary, among other health beneficiaries, may reasonably require access to health information, including projected uninsured costs of treatment. Obtaining the required written authorization at the commencement of the trust administration may be advantageous.

If you would like to receive more detailed information, or a suggested form of authorization, please contact our office.

