NEW YORK STATE BAR ASSOCIATION TAX SECTION

Report Responding to Notice 2008-32, Request for Comments Regarding Treatment of Executors' and Trustees' Commissions under IRC Section 67(e)

July 9, 2008

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Report Responding to Notice 2008-32, Request for Comments Regarding Treatment of Executors' and Trustees' Commissions Under IRC Section 67(e)

I. INTRODUCTION

This report[1] responds to the request for comments in Notice 2008-32 (the "**Notice**") regarding the treatment of executors' and trustees' commissions and fees[2] under Prop. Treas. Reg. § 1.67-4 (the "**Proposed Regulations**"). The proposed regulations provide guidance on which costs incurred by estates and non-grantor trusts are subject to the "two percent floor" for miscellaneous itemized deductions under Section 67(a) (the "**Two Percent Floor**"), and treats costs that are categorized as not unique to the administration of an estate or trust as subject to the Two Percent Floor. The Proposed Regulations also include guidance indicating that, for purposes of determining the deductibility of an executor's or trustee's commission, the commission should be "unbundled" and allocated among the specific types of services provided by the fiduciary, such as custody, investment management, distributing property and communicating with beneficiaries, etc., with the portions of such commissions allocable on some reasonable basis to (i) services categorized as non-unique costs, including custody

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[1] The principal drafters of this report were Carlyn S. McCaffery and Jeffrey N. Schwartz. Helpful comments were received from Jonathan G. Blattmachr, Ralph A. Cheifetz, Sarah DeBergalis, Stephen Land, Robert Levinson, Erika Nijenhuis, David Miller, Edward Morgan, Andrew Oringer, Michael Schler, Barbara Sloan and Robert Weaver.

[2] This report uses the terms fiduciary "commissions" and "fees" interchangeably.

and investment management services, being subject to the Two Percent Floor and (ii) services categorized as unique costs, including property distribution and beneficiary communication services, as not being subject to the Two Percent Floor.[3]

This report discusses two possible alternative approaches towards the treatment of executors' and trustees' commissions. Under one approach, which we refer to as the "Simple Approach", fees paid to executors and trustees for traditional estate and trust administration services generally would not be subject to the Two Percent Floor. This approach, however, would include a narrowly focused unbundling rule intended to prevent taxpayers from circumventing the U.S. Supreme Court's decision in *Knight v. Commissioner*[4] by effectively bundling the fees of third-parties to whom an executor or trustee has delegated all or a portion of its fiduciary duties and responsibilities into a single executor's or trustee's fee.

Under the second approach, which is the approach reflected in the Proposed Regulations, the basic rule for determining the deductibility of executors' and trustees' commissions would require an executor's or trustee's commission to be unbundled and allocated among the services provided by the executor or trustee, without taking into consideration the identity of the service

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[3] Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "**Code**") and to the Treasury Regulations proposed or promulgated thereunder.

[4] 552 U.S. ___, (2008).

provider as an executor or a trustee.[5] The report suggests two safe harbors in connection with this approach. Under the first safe harbor, executors' commissions would not be unbundled (i.e., they would be entirely exempt from the Two Percent Floor) if they are either (1) a fixed dollar amount fee that is not tied to the duration of the administration of the estate or (2) calculated in accordance with rates that are not tied to the duration of the administration of the decedent's estate and are applied to (x) the value of the income and assets collected and disbursed in the course of administering the decedent's estate during a reasonable period of estate administration or (y) the value of the decedent's gross estate as determined for federal estate tax purposes. Under the second safe harbor, trustees' commissions for "non-directed trustees" (e.g., trustees that are not required to follow the instructions of another party with respect to investment management) would not be unbundled (and would be exempt from the Two Percent Floor) to the extent of the commission that would be payable under applicable local law to a similarly situated trustee possessing no special skills (*i.e.* a non-professional trustee of a trust with the same, assets, beneficiaries, number of trustees and governing instrument (excluding any provisions relating to the

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[5] To illustrate the difference between the two approaches, in the case of a professional trustee that offers discretionary distribution decision making, investment management, custody and fiduciary income tax return preparation services that it provides directly in its capacity as trustee, under the Simple Approach the related trustee's fee covering these services would not be subject to the Two Percent Floor because theses services are traditional services provided by a professional trustee. Under the second approach, the trustee's fee would be required to be allocated among the particular services provided. Under the Proposed Regulations, the portions of the trustee's fee allocable to discretionary distribution decision making and fiduciary income tax return preparation services would not be subject to the Two Percent Floor while the portion allocable to custody and investment management services would be subject to the Two Percent Floor.

compensation of trustees)). The excess commission, if any, would be allocable in whole or in part to costs that are subject to the Two Percent Floor depending upon the nature of the services provided in excess of those traditionally provided in the relevant jurisdiction by a non-professional trustee. For purposes of the trustee commission safe harbor described above, reliance on statutory trust commission rate schedules would be permitted for purposes of determining the compensation that would be payable to a non-professional trustee.

II. BACKGROUND

A. The Two Percent Floor

Section 67(a) provides that, in the case of an individual, miscellaneous itemized deductions for any taxable year are allowed only to the extent that the aggregate amount of the deductions exceeds 2% of the taxpayer's adjusted gross income. Miscellaneous itemized deductions are also not deductible for alternative minimum tax purposes.

Section 67(e) provides that, for purposes of Section 67,

> "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; and
>
> (2) the deductions allowable under sections 642(b), 651, and 661,
>
> shall be treated as allowable in arriving at adjusted gross income. Under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter [dealing with

the income taxation of estate, trusts and beneficiaries] to take into account the provisions of this section."[6]

B. Prior Practice and Development in the Case Law

Since Section 67(e) first became effective for tax years beginning after December 31, 1986, the general practice among fiduciaries has been to treat all executors' and trustees' commissions as exempt from the Two-Percent Floor. The proper treatment of fees paid from an estate or trust to a third-party investment manager (i.e., a person other than the trustee acting in its capacity as trustee), however, has been an issue of contention.

The first Court of Appeals decision to address the deductibility of fees paid from an estate or trust to a third-party investment manager was *O'Neill v. Commissioner*.[7] *O'Neill* involved a trust created in 1965 for the benefit of the settlor's family that had three individual co-trustees who did not receive any commissions for acting as trustees and did not have any particular expertise in investment management. For 1987, the taxable year at issue in the case, the trustees deducted on the trust's income tax return the full amount of the fees paid to a third-party investment advisor without regard to the Two Percent Floor.

In reaching its decision that the investment advisory fees at issue in *O'Neill* were not subject to the Two Percent Floor, the Sixth Circuit contrasted the

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[6] Treasury has reserved the designation § 1.67-4T for such regulations, but no such regulations have been proposed or finalized. Commentators have noted that the Proposed Regulations do not fall within this description. See Robert S. Balter and Jonathan G. Blattmachr *Knight Addresses 2 Percent Floor and Fiduciary Investment Advisory Fees*, BNA Daily Tax Report, April 14, 2008, J1 at note 11.

[7] 994 F.2d 302 (6th Cir. 1993).

situation of individual investors who are not required to consult advisors and who suffer no penalties or potential liability if they act negligently for themselves with the situation of "fiduciaries [who] uniquely occupy a position of trust for others and have an obligation to the beneficiaries to exercise proper skill and care with the assets of the trust."[8] Under these circumstances, the Sixth Circuit concluded that, for purposes of Section 67(e), the investment advisory expenses should be treated as costs that would not have been incurred if the property had not been held in trust and should not be subject to the Two Percent Floor.

The second Court of Appeals decision dealing with the deductibility of fees paid from a trust to third-party service providers was *Mellon Bank, N. A. v. United States*.[9] This case involved a corporate trustee that, following the Sixth Circuit's decision in *O'Neill*, filed an amended return with respect to an earlier tax year seeking a refund for expenditures paid for outside (i.e. non-trustee provided) services employed in administering the trust, including for investment strategy advice and financial management.

In analyzing the relevant issues, the Federal Circuit rejected the trustee's suggested construction of Section 67(e) which, based on *O'Neill,* focused on the importance of fiduciary duties, observing that,

> fees are fully deductible [under Section 67(e)] if they are "costs which are paid or incurred in connection with the administration of the estate or trust." This prerequisite defines the relationship between the costs and the administration of the trust. All expenses

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[8] O'Neill, 994 F.2d at 304.

[9] 265 F.3d 1275 (CA Fed. 2001).

> resulting from the fiduciary obligations of the trustee satisfy the first prerequisite [under Section 67(e)]. Mellon Bank's proposed construction of the statute would end here. Mellon Bank argues that trustees are fulfilling their fiduciary duty when they, acting in good faith, incur expenses in connection with the administration of a trust. Therefore, as Mellon asserts, all expenses incurred by a trustee in connection with the administration of a trust would be fully deductible. This argument eliminates the second requirement of section 67(e)(1), which is directed to the question whether an expense would not have been incurred if there had been no trust.[10]

The Federal Circuit concluded that "only those trust-related administrative expenses that are unique to the administration of a trust and not *customarily* incurred outside of trusts"[11] are fully deductible without regard to the Two Percent Floor and subjected the particular costs at issue to the Two Percent Floor.

The next Court of Appeals decision addressing the deductibility of fees paid from a trust to a third-party investment advisor was *Scott v. United States*.[12] In *Scott*, the Fourth Circuit agreed with the analysis of the Federal Circuit in *O'Neill* and held that "[b]ecause investment-advice fees are *commonly* incurred outside the context of trust administration, they are subject to the two percent floor."[13]

Subsequent to *Scott*, the Court of Appeals for the Second Circuit issued its decision in *Rudkin v Commissioner*.[14] In *Rudkin*, the Second Circuit formulated a more restrictive test under Section 67(e) than either the Federal Circuit or the

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[10] Mellon, 265 F.3d at 1280.

[11] Mellon, 265 F.3d at 1281 (emphasis added)

[12] 328 F.3d 132 (4th Cir. 2003).

[13] Scott, 328 F.3d at 140 (emphasis added).

[14] 467 F.3d 149 (2d Cir. 2006).

Fourth Circuit, holding that only costs that are "peculiar to trusts" and that individuals are "incapable of incurring" are fully deductible by trusts without regard to the Two-Percent floor.[15] It was this decision that was appealed and ultimately decided by the U.S. Supreme Court in *Knight v. Commissioner*.[16] The U.S. Supreme Court's decision in *Knight* is discussed in section III below.

C. Regulatory Developments

In July, 2007, while *Knight* was pending before the U.S. Supreme Court, the IRS and Treasury issued the Proposed Regulations, which provide guidance on the costs incurred by estates and non-grantor trusts that are subject to the Two Percent Floor. The Proposed Regulations would require executors' and trustees' commissions to be allocated on some reasonable basis among different categories of costs for purposes of determining whether all, none or a portion of the relevant commission is subject to the Two Percent Floor.

On January 16, 2008, the U.S. Supreme Court issued its decision in *Knight*, holding that fees paid from a trust to a third-party investment advisor (i.e., a party other than the trustee) for investment advisory services generally are subject to the Two Percent Floor.

On February 27, 2008, the IRS issued Notice 2008-32, which provides interim guidance on the treatment of fiduciary fees under Section 67. The Notice indicated that (i) the IRS and the Treasury expect to issue final regulations

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[15] Rudkin, 467 F.3d at 156.

[16] 552 U.S. ___, (2008).

consistent with the Supreme Court's holding in *Knight*, (ii) the final regulations will address the issue raised when a non-grantor trust or estate pays a single fee (referred to in the Notice as a "**Bundled Fiduciary Fee**") for costs incurred in-house by a fiduciary, some of which under the Proposed Regulations would be subject to the Two Percent Floor and some of which under the Proposed Regulations would be fully deductible without regard to the Two Percent Floor, (iii) the final regulations may include safe harbors for determining the allocation of a Bundled Fiduciary Fee between costs subject to the Two Percent Floor and those that are not, and (iv) the final regulations will apply prospectively only. Under Notice 2008-32, for any taxable year beginning before January 1, 2008, taxpayers may deduct the full amount of a Bundled Fiduciary Fee without regard to the Two Percent Floor, which, as mentioned above, has been the general practice since Section 67(e) first became effective for tax years beginning after December 31, 1986.

The Notice also requested comments on whether safe harbors would be helpful and suggestions on how the safe harbors may be formulated. Comments were specifically requested on reasonable estimates of the percentage(s) of the total costs of administering a non-grantor trust or estate that are attributable to costs subject to the Two Percent Floor, including costs for investment management and advice. Comments were also requested on whether the safe harbors should reflect the nature or value of the assets in the non-grantor trust or estate, and/or the number of beneficiaries of the non-grantor trust or estate.

D. Executors' and Trustees' Commissions in General

The fees typically payable to executors and trustees vary from state to state, can also vary between different geographical regions within a state and, particularly in the case of professional fiduciaries, may vary from fiduciary to fiduciary within a geographical region. Professional fiduciaries often have "published fee schedules" which they use in marketing their services. Those fee schedules may reflect a single, bundled fee covering all services or may include separate charges for administrative, investment management and other services. Professional fiduciaries may also negotiate special fee arrangements that depart from their published fee schedules, particularly in the case of larger estates and trusts. In all cases, however, the fees are intended to represent reasonable compensation for the services rendered to the particular estate or trust, as well as the increased fiduciary duties and corresponding potential personal liabilities of an executor or trustee relative to a "mere" agent that might be engaged by an individual taxpayer.

Generally, the services of an executor extend over a period of one to three years, during which the executor collects and safeguards assets, sells assets to raise cash to pay estate administration expenses, determines and pays claims and debts, files relevant tax returns and distributes property to the beneficiaries of the estate. The fee for providing these services and undertaking the associated fiduciary risks is typically calculated based upon the value of the income and assets collected and disbursed in the course of administering the estate, or in the

case of some professional fiduciaries, based upon the federal estate tax value of the decedent's gross estate.

A trustee, by way of comparison, typically renders services, including investment management, over a more extended period of time than an executor. As compensation for its services and assumption of fiduciary risks, a trustee typically charges an annual commission based upon the income received during that year and/or the principal value of the trust on one or more valuation dates. A trustee may also be entitled to additional commissions based upon the value of principal distributed from the trust, including on termination. A relatively new development in some jurisdictions is the growth of "directed" or "administrative" trustees who perform limited functions and charge an asset based fee only for those functions, such as holding assets, making discretionary distribution decisions and filing tax returns. These directed or administrative trustees typically take investment direction from other fiduciaries.

As a broad generalization, states may be divided into "reasonable compensation" states, under whose laws a trustee is entitled to reasonable compensation and pursuant to which a trustee takes the compensation that the trustee believes to be reasonable, subject to potential challenge by the trust beneficiaries, and "statutory commission" states, under whose laws a trustee is entitled to commissions at the rates and in manner set forth by statute. In either case, the terms of the relevant trust instrument may provide for alternative compensation by, for example, referencing a professional fiduciary's published fee schedule, providing that family members are to serve as trustees for no or

some fixed dollar amount of compensation, or providing some alternative mechanism for determining compensation.

Our research has identified eight jurisdictions in the United States that may be classified as statutory trustee commission jurisdictions. These jurisdictions are Delaware,[17] Georgia, Hawaii, Kentucky, Maryland, New Jersey, New York and Puerto Rico.[18] A summary description of these commission schedules is attached as Exhibit A.

As reflected by Exhibit A, each of the statutory trustee commission jurisdictions has its own particular rules for computing trustee fees. The New York statute, for example, contains one statutory rate schedule for determining the annual commissions of individual trustees and a separate, higher statutory rate schedule for determining the annual commission of corporate trustees which are presumed to provide more services than an individual trustee.[19] In either case, a trustee of a New York trust, in addition to its annual commission, is entitled to a statutory "paying commission" on the amount of trust principal distributed from

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[17] Although trustees are generally entitled to reasonable compensation under Delaware law, we have included Delaware in the category of statutory commission jurisdictions based upon our understanding that "non-qualified trustees" (trustees others than those subject to supervision by the Delaware Bank Commissioner, the FDIC or the U.S. Comptroller of the Currency), are generally entitled to compensation in accordance with a Delaware Chancery Court Rule setting forth detailed guidelines for computing commission.

[18] The statutory scheme in Puerto Rico appears to establish a statutory minimum and maximum compensation guidelines, as opposed to a specific commission rate.

[19] For example, a corporate trustee of a New York trust is generally held to a higher standard of care in investing trust assets than an individual trustee and, unlike an individual trustee, would traditionally be expected to provide custody and income tax return preparation services as part of its trust services.

the trust. Additional commissions may also be payable to trustees managing real property. Specific rules govern the calculation and timing of the payment of these statutory commissions, as well as the calculation of commissions payable to multiple trustees. Adding to the complexity, New York law permits corporate trustees of trusts with a principal value in excess of four hundred thousand dollars to elect to take "reasonable commissions" in lieu of statutory commissions, i.e. as though they were in effect subject to the rules of a reasonable compensation state. Other jurisdictions, no doubt, have their own special rules and related complexities.

III. KNIGHT V. COMMISSIONER

As indicated above, prior to the U.S. Supreme Court's decision in *Knight*, the U.S. Courts of Appeals were divided on the question as to whether investment advisory fees incurred by a trust were subject to the Two Percent Floor. As the Supreme Court explained:

> The Sixth Circuit . . . held that investment advisory fees are fully deductible. . . . In contrast, both the Fourth and Federal Circuits . . . held that such fees are subject to the 2% floor, because they are "commonly" or "customarily" incurred outside of trusts. . . . The Court of Appeals [for the Second Circuit] came to the same conclusion, but as noted announced a more exacting test, allowing "full deduction only for those costs that could not have been incurred by an individual property owner."[20]

In deciding that the investment advisory fees at issue in *Knight* were subject to the Two Percent Floor, the Supreme Court rejected the approach of the Sixth Circuit and the more exacting "could not" test of the Second Circuit

[20] 552 U.S. ___, (2008) (citations omitted).

mentioned above, explaining in connection with its analysis of the Second Circuit's decision that fees that could not have been incurred by an individual are merely a subset of fees that would not have been incurred if property were not held in trust:

> In applying the statute, the Court of Appeals below asked whether the cost at issue could have been incurred by an individual. This approach flies in the face of the statutory language. The provision at issue asks whether the costs "would not have been incurred if the property were not held" in trust, ibid., not, as the Court of Appeals would have it, whether the costs "could not have been incurred" in such a case. . . . The fact that an individual could not do something is one reason he would not, but not the only possible reason. If Congress had intended the Court of Appeals' reading, it easily could have replaced "would" in the statute with "could," and presumably would have. The fact that it did not adopt this readily available and apparent alternative strongly supports rejecting the Court of Appeals' reading.[21]

After rejecting the approaches of the Sixth and Second Circuits, the Supreme Court indicated its agreement with the approach of the Fourth and Federal Circuits, stating:

> This brings us to the test adopted by the Fourth and Federal Circuits: Costs incurred by trusts that escape the 2% floor are those that would not "commonly" or "customarily" be incurred by individuals. See Scott, 328 F. 3d, at 140 ("Put simply, trust-related administrative expenses are subject to the 2% floor if they constitute expenses commonly incurred by individual taxpayers"); Mellon Bank, 265 F. 3d, at 1281 (§67(e) "treats as fully deductible only those trust-related administrative expenses that are unique to the administration of a trust and not customarily incurred outside of trusts"). . . . We agree with this approach.[22]

The Supreme Court further explained that:

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[21] 552 U.S. ___, (2008) (citations and notes omitted).

[22] 552 U.S. ___, (2008).

> The question whether a trust-related expense is fully deductible turns on a prediction about what would happen if a fact were changed - specifically, if the property were held by an individual rather than by a trust. In the context of making such a prediction, when there is uncertainty about the answer, the word "would" is best read as "express[ing] concepts such as custom, habit, natural disposition, or probability." Scott, supra, at 139. See Webster's Third New International Dictionary 2637-2638 (1993); American Heritage Dictionary 2042, 2059 (3d ed. 1996). . . . Thus, in asking whether a particular type of cost "would not have been incurred" if the property were held by an individual, §67(e)(1) excepts from the 2% floor only those costs that it would be uncommon (or unusual, or unlikely) for such a hypothetical individual to incur.[23]

Having set forth its interpretation of Section 67(e)(1), the Supreme Court applied the test it adopted from the Fourth and Federal Circuits to conclude that investment advisory fees paid from a trust to a third-party investment advisor engaged by the trustee in its fiduciary capacity are generally subject to the Two Percent Floor, explaining that:

> it is quite difficult to say that investment advisory fees "would not have been incurred" – that is, that it would be unusual or uncommon for such fees to have been incurred – if the property were held by an individual investor with the same objectives as the Trust in handling his own affairs.
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> * * *
>
> As the Solicitor General concedes, some trust-related investment advisory fees may be fully deductible "if an investment advisor were to impose a special, additional charge applicable only to its fiduciary accounts." . . . There is nothing in the record, however, to suggest that Warfield [the investment advisor] charged the Trustee anything extra, or treated the Trust any differently than it would have treated an individual with similar objectives, because of the Trustee's fiduciary obligations. . . . It is conceivable, moreover, that a trust may have an unusual investment objective, or may require a specialized balancing of the interests of various

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[23] 552 U.S. ___, (2008).

> parties, such that a reasonable comparison with individual investors would be improper. In such a case, the incremental cost of expert advice beyond what would normally be required for the ordinary taxpayer would not be subject to the 2% floor. Here, however, the Trust has not asserted that its investment objective or its requisite balancing of competing interests was distinctive. Accordingly, we conclude that the investment advisory fees incurred by the Trust are subject to the 2% floor.[24]

IV. CONSISTENCY OF PROPOSED REGULATIONS WITH KNIGHT AND COURTS OF APPEALS DECISIONS

The Proposed Regulations differ from the analysis set forth in *Knight* in two important respects. First, instead of defining costs that are "unique" to an estate or trust in accordance with the Fourth and Federal Circuit formulations of the relevant inquiry, the Proposed Regulations follow the Second Circuit formulation rejected in *Knight* and define costs that are unique to an estate or trust as costs that an individual could not have incurred in connection with property not held in an estate or trust. As indicated in the Notice, the final regulations will be consistent with the *Knight* holding. Therefore, we expect that the final regulations will define unique costs as those that would not commonly or customarily be incurred by individuals.

Second, the Proposed Regulations go beyond the specific issue addressed in *Knight* (i.e., the deductibility of investment advisory fees paid from a trust to a third-party investment advisor engaged by the trustee) and provide that the determination of whether a cost is unique to an estate or trust is based solely on

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[24] 552 U.S. ___, (2008).

the type of product or service rendered to the estate or trust, without regard to the identity of the provider. It is this position that leads to the conclusion reflected in the Proposed Regulations, and assumed to be correct in the Notice that, for purposes of determining deductibility, a trustee's or executor's commission should be unbundled and allocated on some reasonable basis among the specific types of services provided by the fiduciary, with the cost of certain of such services, such as custody and investment management, being characterized as non-unique costs and therefore subject to the Two Percent Floor, and the cost of other services, such as distributing property and communicating with beneficiaries, being characterized as unique costs and thus not subject to the Two Percent Floor. Reasonable arguments can be made that this approach towards unbundling trustee commissions is appropriate, e.g., that formalism in labeling costs should not permit taxpayers to obtain services from a trustee whose costs, if obtained from a third-party provider of equivalent services, would be subject to the Two Percent Floor. Reasonable arguments can also be made that this approach towards unbundling is inconsistent with the statutory interpretation reflected in *Knight* and differs from the analysis of each of the Courts of Appeals decisions addressing the application of the Two Percent Floor to investment advisory fees.

As indicated above, although the *Knight* decision does not specifically address trustee fees, the Supreme Court did explain in the context of rejecting the Second Circuit's "could not" formulation of the "would not" test under Section 67(e) that the fact that an individual could not do something is one reason he

would not, but not the only possible reason. Following this reasoning, one could argue that expenses such as executors' and trustees' commissions fall within the category of expenses that would not commonly or customarily be incurred by individuals because, as a technical matter, those costs cannot be incurred by individuals.[25] Under this reasoning, executors' and trustees' commissions should not be subject to the Two Percent Floor, regardless of whether all or a portion of the underlying services are similar to the services that an individual could obtain from an agent. In this regard, we note that each of the Courts of Appeals that focused on the issue of trustee fees in the context of determining the deductibility of investment advisory fees under the Two Percent Floor appear to have either assumed or endorsed the foregoing analysis. It is also true, however, that the cases themselves did not address the possibility of unbundling trustees' fees among particular services.

In *O'Neill*, the Sixth Circuit explained that

> Expenses such as trustee fees, costs of construction proceedings and judicial accountings are examples of expenses peculiar to a trust and, therefore, are subject to the § 67(e) exception [and are not subject to the Two Percent Floor].[26]

It was only after making this basic statement regarding the Two Percent Floor that the Sixth Circuit adopted the approach that was ultimately rejected in *Knight*,

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[25] Individuals may appoint a fiduciary of an estate or trust, but the fiduciary is not an employee or agent of the individual, e.g., individuals employ investment advisors but not trustees. In *Knight*, the Supreme Court also indicated that, in the case of investment advisory fees paid by a trustee to a third-party investment advisor, the incremental cost of expert advice beyond what would normally be required for the ordinary taxpayer would not be subject to the Two Percent Floor.

[26] O'Neill v. Commissioner, 994 F. 2d 302, 304 (6th Cir.1993).

namely its determination that, where a trustee lacks experience in investment matters and must engage a third-party investment advisor to meet its fiduciary duties, the third-party fees should effectively be treated the same as trustee commissions.

In *Mellon*, the Court of Appeals for the Federal Circuit explicitly stated that it was "undisputed" that trustee fees are fully deductible without regard to the Two Percent Floor but rejected the corporate trustee's argument that fees paid to a third-party investment advisor should be equated with trustee fees.[27] The Federal Circuit further admonished the corporate trustee that:

> The Supreme Court has "observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, . . . and may not enjoy the benefit of some other route he might have chosen to follow but did not." [citation omitted]. Mellon Bank chose to hire outside consultants to satisfy their fiduciary duty as trustees. The plain meaning of I.R.C. § 67(e)(1) prevents the deduction of fees thus incurred unless they satisfy the general requirement of I.R.C. § 67(a).[28]

The clear implication of this statement is that, if Mellon Bank had chosen to provide investment management services in-house instead of hiring an outside consultant, its trustee's commission for its enhanced services would have been fully deductible.

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[27] Mellon Bank, N. A. v. United States, 265 F. 3d 1275, 1279 (CA Fed. 2001).

[28] Mellon, 265 F. 3d at 1281.

In *Scott*, the Fourth Circuit also clearly indicated that, under its formulation of the relevant inquiry, trustee fees would not be subject to the Two Percent Floor, explaining that,

> because investment-advice fees [paid to investment advisors] are commonly incurred outside the context of trust administration, they are subject to the 2% floor created by § 67(a). Other costs ordinarily incurred by trusts, such as *fees paid to trustees*, expenses associated with judicial accountings, and the costs of preparing and filing fiduciary income tax returns, are not ordinarily incurred by individual taxpayers, and they would be fully deductible under the exception created by § 67(e).[29]

Similarly, although it adopted a more stringent formulation for the relevant inquiry that was ultimately rejected by the Supreme Court, the Second Circuit shared the Fourth Circuit's view that fees paid to trustees are fully deductible, explaining that

> the fact that investment-advice fees are subject to the Two Percent floor under regulations applicable to individual taxpayers proves the fees to be a cost that individual taxpayers are capable of incurring. Investment-advice fees and other costs that individual taxpayers are capable of incurring are, therefore, not fully deductible pursuant to § 67(e)(1) when incurred by a trust. By contrast, costs that individuals are incapable of incurring, like "fees paid to trustees, expenses associated with judicial accountings, and the costs of preparing and filing fiduciary income tax returns," Scott, 328 F.3d at 140, are fully deductible.[30]

V. ALTERNATIVE APPROACHES.

We discuss two alternative approaches. The first approach, which we refer to as the Simple Approach, would not generally require unbundling and therefore would not generally treat fees paid to executors and trustees as subject

[29] Scott, 328 F.3d at 140 (emphasis added).

[30] Rudkin v Commissioner, 467 F.3d 149, (2d Cir. 2006).

to the Two Percent Floor. This approach, however, would include a narrowly focused unbundling rule intended to prevent taxpayers from circumventing the U.S. Supreme Court's decision in *Knight v. Commissioner* by effectively bundling the fees of third-parties to whom an executor or trustee has delegated all or a portion of its fiduciary duties and responsibilities into a single executor's or trustee's fee.

The second approach, which is the approach reflected in the Proposed Regulations, would generally require executors' and trustees' commissions to be unbundled and allocated among the services provided by an executor or trustee. This approach would be subject to two safe harbors.

We describe and discuss each of these approaches in turn. In this regard, it should be noted that one's intuitive reaction as to whether executors' and trustees' commission are, on their face, costs that could not, and therefore would not, be incurred by individuals for purposes of the relevant analysis under Section 67(e), may influence one's views regarding the relative merits of these approaches.[31]

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[31] For example, one's reaction regarding the plain meaning of the statute may influence one's view as to whether the policy considerations raised below in connection with the discussion of the first approach are more appropriately addressed through the regulatory or legislative process. Also, some have suggested that trustees of trusts that are significantly adversely affected by the second approach might believe that they have a fiduciary duty to challenge the approach on the basis that it is not in keeping with a plain reading of the statute. A discussion of these issues is beyond the scope of this report.

A. Simple Approach/Limited Unbundling

First, under the Simple Approach, the Proposed Regulations would be modified to make clear that fees paid to executors and trustees for traditional estate and trust administration services, including any portion that may be allocable to investment management or custody functions which the executor or trustee has not delegated to a third-party and for which it therefore retains full fiduciary liability, are not subject to the Two Percent Floor. While this approach would still include an unbundling rule, the unbundling rule would be narrowly focused on preventing taxpayers from circumventing the basic rule adopted in *Knight* (i.e., that fees payable to non-trustee service providers for services customarily rendered to individuals are subject to the Two Percent Floor) by, for example, employing a trustee who might engage an investment manager for a particular trust, gross up its own trustee's commission in an amount equal to the third-party's fees and take the position that it was paying the third-party out of its own, fully deductible commission. Such a limited, anti-abuse focused unbundling rule might provide that, when an executor or trustee charges a single fee that covers both traditional and non-traditional estate and trust administration services and/or both its own services and those of a third-party to whom the executor or trustee has delegated an estate or trust investment or management function, that the single fee must be allocated on a reasonable basis among these various components, with the deductibility of the portion allocable to non-traditional trust services (for example, services other than custody, investment management, income tax return preparation, discretionary distribution decision making and

communicating with beneficiaries) or delegated functions to be determined as if the fee were paid to a person other than an executor or trustee.

The Simple Approach, which takes into consideration the identity of the service provider as an executor or trustee as a factor in determining deductibility under the Two Percent Floor, follows from the language in the Courts of Appeals decisions that appears to recognize executors' and trustees' commissions as costs that could not, and therefore would not, commonly or customarily be incurred by individuals. This approach also generally avoids the difficulties associated with unbundling executors' and trustees' commissions and the potential administrative burdens of auditing fiduciary income returns for purposes of examining the basis on which commissions are unbundled.[32] Finally, this approach would to some extent be a continuation of the interim guidance provided in Notice 2008-32 and the general practice in effect since 1986.

While administratively attractive, the Simple Approach would create an incentive for the appointment of "full-service" executors and trustees (*i.e.*, those with robust, internal investment management and other traditional trustee function capabilities), as compared to family members, friends or more limited-service fiduciaries. A full-service fiduciary would presumably charge a higher fee and engage fewer third-party service providers than a limited-service fiduciary. While

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[32] Given their fiduciary duties, the identity of the trust (and not the trustee) as the relevant taxpayer, and the fact that an appropriate unbundling would necessarily depend upon the facts and circumstances relating to the administration of the particular trust, we are doubtful that a professional trustee could effectively enter into "advance pricing" or other similar agreements that might otherwise ease the potential burden of developing appropriate audit guidelines in this area.

the larger fee of the full-service fiduciary would not be subject to the Two Percent Floor, the additional fees paid from a trust with a limited-service fiduciary to third-party service provides would in many cases, depending on the particular services being rendered, be subject to the Two Percent Floor.[33] In situations where the recipient of an outright gift would otherwise require the assistance of a third-party investment advisor, the Simple Approach would also create an incentive to substitute gifts in trust for outright gifts. On the other hand, given the other considerations that impact upon the decision to fund a trust instead of making an outright gift, the choice of fiduciaries and the selection of in-house versus external investment advisors and other service providers, the fact that the choice of the form of a gift (e.g., outright or in trust) or of a particular trustee (e.g. full service vs. limited service) may have tax consequences with respect to the Two Percent Floor may be less important than it might first appear.[34]

B. Unbundling with Safe Harbors

The second approach, which is reflected in the Proposed Regulations, would start with a basic rule requiring that an executor's or trustee's commission be unbundled and allocated among the services provided by the executor or

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[33] For example, third party investment advisory fees would in most cases be subject to the Two Percent Floor. Under the Proposed Regulations, fees paid to third parties for fiduciary income tax return preparation services would not be subject to the Two Percent Floor.

[34] The choice of a particular person to act as a trustee may also have a number of significant income tax consequences unrelated to the Two Percent Floor, including potentially causing a trust to be treated as a so-called grantor trust that is effectively disregarded for U.S. federal income tax purposes, as a foreign trust instead of a separate U.S. taxpayer, or as a taxpayer that is subject to particular state level income taxes.

trustee, without taking into consideration the identity of the service provider as an executor or a trustee. If this approach is adopted, we would suggest a safe harbor for executors' commissions and a separate safe harbor for trustee's commissions. (Each of these is described below.) Commissions that are described in one of these two safe harbors would not be unbundled and therefore would not be subject to the Two Percent Floor.[35] We would also request the inclusion of examples to provide additional guidance regarding acceptable approaches towards unbundling fiduciary commissions to reflect an appropriate allocation between core fiduciary services and services that might customarily be provided to individuals.

1. Executors' Commissions. Given the typical role of an executor, which is more focused on paying debts and collecting and safeguarding assets for distribution to beneficiaries than long-term investment management, and the generally limited time period for administering an estate, we suggest a safe harbor that fully excepts from the Two Percent Floor executors' commissions that are either (i) a fixed dollar amount fee that is not tied to the duration of the administration of the decedent's estate or (ii) calculated in accordance with rates that are not tied to the duration of the administration of the decedent's estate and are applied to the value of the income and assets collected and disbursed in the course of administering the decedent's estate during a reasonable period of estate administration or upon the value of the decedent's gross estate as determined for

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[35] By suggesting these two safe harbors, we are not negating the possibility that other safe harbors may also be appropriate.

federal estate tax purposes, without any requirement that those commissions be allocated among particular services. As reflected by the non-periodic, non-hourly basis on which executor's commissions are typically calculated, these fees are significantly different than the periodic or hourly payments an individual might incur in connection with engaging an investment manager, custodian, attorney or other agent. The requirement that the rates not be tied to the duration of the administration of the decedent's estate is intended to protect against the theoretical possibility of creating executors' commission rate schedules that might mimic periodic charges. This could occur, for example, if the schedule provided for one fixed fee or rate if the administration of the decedent's estate is concluded within three years, with an increased fixed fee or rate if administration extends beyond that time period.

2. Trustees' Commissions. In the case of the commissions of "non-directed" trustees (e.g., trustees that are not required to follow the instructions of another party with respect to investment management), we suggest that final regulations provide a safe harbor for the fees that would have been payable to a corresponding non-professional trustee of the relevant trust under applicable local law in the absence of any specific language in the trust instrument, i.e., to a non-directed trustee who would not be expected to possess any special investment or other skills and would therefore be anticipated to receive a base fee for its own services and to employ, at an additional cost to the trust, a third-party custodian and other appropriate third-party agents and advisors possessing special skills to the same extent that an individual requiring similar services might employ such

agents. Presumably, the fees payable to such a non-professional trustee or trustees would be compensation for the core fiduciary functions and liabilities associated with administering a trust and should therefore not be subject to the Two Percent Floor.

In the case of a non-directed professional trustee (*i.e.*, one possessing special investment or other skills similar to those provided by professionals to individuals managing their own personal affairs), the portion of any fee in excess of that payable to a similarly situated non-professional trustee might be treated as a fee paid to an unrelated third party and be further allocated among the particular special services being provided (be they additional investment management, custody, income tax return preparation or other services not typically provided by a non-professional trustee) for purposes of determining whether all or only a portion of the excess is subject to the Two Percent Floor.

In the case of a directed trustee (i.e., one who acts at the direction of another party), we believe it would be appropriate to treat that trustee as the agent of the party providing the direction and to require that any associated fee for implementing the related direction be treated in the same manner as a fee paid from the trust to a third-party service provider. For example, the proposed safe harbor would not apply to the situation in which a group of individual trustees had the responsibility for setting broad investment policies and could then direct a professional co-trustee to implement those investment policies.

Admittedly, taking advantage of the safe harbor described above would require non-directed professional trustees to run multiple commission

computations, the first based upon their actual fee arrangements and the second based upon a hypothetical non-professional trustee, and could raise complicated issues, such as how to appropriately take into consideration principal paying commissions to which a non-directed, non-professional trustee might be entitled in situations in which a non-directed professional trustee has elected to forgo those commissions in exchange for charging a higher, annual commission. Nevertheless, under the proposed safe-harbor, most non-professional trustees would likely conclude that their entire commission is not subject to the Two Percent Floor. Moreover, the safe harbor would provide a meaningful starting point for non-directed professional trustees to determine the deductible portion of their fees. In the case of a non-directed professional trustee of a trust governed by the laws of a non-statutory trustee commission jurisdiction, the safe harbor might further permit the calculation of a hypothetical non-directed, non-professional trustee commission in accordance with the statutory commission fee schedule of a statutory trustee commission jurisdiction selected by the trustee (or some average of the result of applying two or more of those commissions schedules to the particular trust), so long as a consistent practice was followed in connection with the administration of that particular trust (*i.e.*, the non-directed professional trustee might calculate a non-directed, non-professional trustee fee for different trusts based upon different jurisdictions' statutory fee schedules).

If this approach is of interest, we would happy to provide additional assistance in formulating this type of safe harbor.

SIMPLIFIED GENERAL DESCRIPTION OF CALCULATION OF STATUTORY TRUSTEES' COMMISSIONS[1]

Delaware

Source: DEL. CODE ANN. tit. 12, §§ 3561-3562 (2007)
DEL. CT. CH. R. 132 (2008)

Summary:

Subject to judicial review, reasonable compensation is allowed and is determined differently for "qualified trustees" (any person authorized by Delaware or United States law to act as a trustee whose activities are subject to supervision by the Bank Commissioner of the State of Delaware, the FDIC or the Comptroller of the Currency of the United States) and other trustees.

Each qualified trustee is required to file a copy of its schedule or formula for compensation with the Court of Chancery.

The Court of Chancery issues a rule fixing the method by which trustees other than qualified trustees may be allowed compensation. This rule, which does not apply to a guardianship over the property of minors, generally sets forth the following rates of compensation:

Annual Income Commissions:

- 6% on the first $20,000 of income
- 3.5% on the next $10,000 of income
- 3% on the next $270,000 of income
- 2% on all income over $300,000

Annual Principal Commissions:

- 5/10 of 1% on the first $100,000 of principal
- 3/10 of 1% on the next $100,000 of principal
- 2/10 of 1% on the next $500,000 of principal
- 1/10 of 1% on all principal over $700,000

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[1] This exhibit is intended to provide a general overview of the default rules that would apply in situations in which a trust instrument does not provide that a trustee is to serve without compensation or otherwise fix the compensation of the trustee. This exhibit is a summary for informational purposes only and should not be relied upon as legal advice.

When the trust includes one or more mortgages, an additional commission is allowed at an annual rate of 1/4 of 1% of the total face value of all mortgages held in trust at times of valuation, or if the trustee is not charging periodic principal commissions, of the total face value of such mortgages held in the trust on the last business day of each fiscal year of the trust.

When the trust includes real estate, the income commission above applies to gross rents collected by an outside agent. If such rents are collected directly by the trustee, a commission of 8% of gross rentals received is allowed.

In the discretion of the Court, additional and special commissions may be allowed for unusual and extraordinary services.

Commissions can be decreased under the following circumstances:

- If the direction and control of investments in any trust, for which the principal exceeds $300,000, rests solely with a person other than the trustee, principal commissions are reduced by 15% so long as such condition exists.
- In a trust with limited diversification and fair value of $1,000,000 or more, 3/4 or more of the fair value of which is invested in not more than 2 blocks of stocks and/or bonds, the income commission is reduced by 25% so long as such condition exists.

Upon partial or complete distribution, the aggregate principal paying out commissions are:

- 5% of principal on first $50,000
- 3.6% of principal on next $50,000
- 2.3% of principal on next $900,000
- 1% of principal on all over $1,000,000

provided, however, that if at time of distribution or transfer the trust has been administered by the trustee for less than 10 years, such principal commissions are reduced to the following percentages of the rates immediately above:

- 30% if termination occurs within 3 years
- 40% if termination after 3 and before 4 years
- 50% if termination after 4 and before 5 years
- 60% if termination after 5 and before 6 years
- 70% if termination after 6 and before 7 years
- 80% if termination after 7 and before 8 years
- 90% if termination after 8 and before 9 years
- 100% if termination after 9 years

Perpetual trusts: Trustee is entitled to the income and periodic principal commissions first noted above.

Co-trustees: Compensation is as the Court determines, computed in a manner consistent with the above schedule, but the amounts allowed in the aggregate may exceed the amounts allowed a single trustee at the rates set forth for normal services.

Trustee's fee for review of accountings of an executor or an administrator other than trustee: Cannot exceed $1,000 without special allowance of the Court.

Successor trustee's fees for review of accountings of former trustee: Cannot exceed $1,000 without special allowance of the Court.

Minimum commissions: A trustee is entitled to a minimum commission of $400 in any accounting year.

Georgia

Source: GA. CODE ANN. §§ 29-5-50 (2007), 53-12-173 (Supp. 2007)

Summary:

A trustee is entitled to the same compensation as a conservator would receive for similar services.

The compensation of a conservator is determined as follows:

- 2.5% commission on all sums of money received by conservator on account of the estate, except on money loaned by and repaid to the conservator, and 2.5% commission on all sums of money paid out by the conservator;
- 10% commission on the amount of interest earned on money loaned by the conservator in that capacity;
- An additional commission equal to 1/2 of 1% computed on the market value of the estate as of the last day of the reporting period (proportionately reduced for any reporting period of less than 12 months);
- Reasonable compensation, as determined in the discretion of the court and after such notice, if any, as the court shall direct, for the delivery over of property in kind, not exceeding 3% of the appraised value and, in cases where there has been no appraisal, not over 3% of the fair value as found by the court, irrespective of whether delivery over in kind is made pursuant to proceedings for that purpose in the court and irrespective of whether the property, except money, is tangible or intangible or personal or real; and
- In the court's discretion, compensation for working land for the benefit of the parties in interest, but not to exceed 10% of the annual income of the managed property.

Hawaii

Source: HAW.REV. STAT. ANN. §§ 607-18, -20 (Supp. 2007)

Summary:

Annual Income Commissions:

- 7% on first $5,000 of income
- 5% on all income over $5,000

Annual Principal Commissions:

- 5/10 of 1% on the value at the expiration of each year, except to extent trustee has employed others to perform bookkeeping and clerical services

Principal Received and Paying Out Commissions:

- 1% on value at inception of trust
- 2.5% upon all cash principal received after inception of the trust and neither being or representing principal upon which the 2.5% has previously been charged
- 2.5% upon final payment of any cash principal prior to termination
- 1% on value of all or any part of estate upon final distribution

Further allowances may be made as the court deems just and reasonable for services in connection with sales or leases of real estate, contested or litigated claims against the estate, the adjustment and payment of extensive or complicated estate or inheritance taxes, the preparation of estate and income tax returns, the carrying on of the decedent's business pursuant to a court order or under the provisions of any will, litigation in regard to the property of the estate, and such other special services as may be necessary for the trustee to perform, prosecute or defend.

Modified rules apply to charitable trusts.

Kentucky

Source: KY. REV. STAT. ANN. § 386.180 (1999 & Supp.2007)

Summary:

Income Commissions:

- 6% of the income collected

Principal Commissions:

- Annual commission of 3/10 of 1% (0.3%) of the fair value of the real and personal estate in the care of the trustee or, at the trustee's option and in lieu of the annual commission on principal, a commission not to exceed 6% of the fair value of the principal distributed, payable when the principal is distributed.

If a trustee has performed additional service in handling the estate, which has been unusual or extraordinary to the care and management of an estate, the court may allow additional compensation as is fair and reasonable for the extra services.

Maryland

Source: MD. CODE ANN., EST. & TRUSTS §14-103 (2001 & Supp. 2007)

Summary[2]:

Annual Income Commissions:

- 6% of income from real estate, ground rents and mortgages collected each year
- 6.5% upon first $10,000 of other income
- 5% upon next $10,000
- 4% upon next $10,000
- 3% upon any excess

Annual Principal Commissions:

- 4/10 of 1% of first $250,000
- 1/4 of 1% of next $250,000
- 3/20 of 1% of next $500,000
- 1/10 of 1% of excess

Sales of Real or Leasehold Property: Special commissions may be allowable by statute or rule of court.

Final distribution: Absent special circumstances, 1/2 of 1% of fair value of principal upon final distribution.

Increased rates of commissions: Trustee that is a financial institution subject to supervision by Maryland, the federal government or which is an instrumentality of the United States, or is a member of the Maryland bar, may charge increased commissions on income and principal if it has filed a schedule of the increased rates with the appropriate agency as stated in the statute and given notice of the scheduled rates or revisions to the ascertained beneficiaries of the trust. Such notice must include a clear statement of the rights and procedures available to the beneficiaries under the statute. A beneficiary may object to the rate schedule by petitioning in circuit court. If the court finds the rates unreasonable for the current fiscal year for that particular trust, the commissions for that year will be limited to the rates charged that trust during the previous fiscal year. A trustee

[2] For accountings from July 1, 1981.

who does not follow the above filing and notification requirements is limited to charging the rates schedules set by the statute.

Individual trustee not authorized to file a schedule of increased rates is limited to the rates set by the statute unless the trustee petitions the appropriate circuit court and obtains approval for an increase after giving notice to the ascertained beneficiaries of the affected trusts.

The increased rate of commissions schedule provisions do not apply to guardians.

New Jersey

Source: N.J. STAT. ANN. §§ 3B:18-24, 25, -25.1, -28, -29, -31 (1983 & Supp. 2008)

Summary:

Income Commissions:

A 6% commission may be taken on income received by the trustee. Income withheld from payment to the trustee pursuant to any laws for income tax or other tax purposes are deemed to be income received by the trustee and subject to income commissions.

Annual Principal Commissions:

- $5 per $1,000 of value on first $400,000 of the value
- $3 per $1,000 of value in excess of $400,000

If the trustee is a banking institution, foreign bank or savings and loan association authorized to exercise fiduciary powers, the trustee is entitled to such commissions as may be reasonable.

Notwithstanding the schedule above, a trustee may take a minimum commission of $100 annually.

If there are two or more trustees, the annual principal commission which may be taken may equal the commission which may be taken when there is one trustee plus 1/5 of the commissions for each trustee more than one.

In addition to the annual principal commissions, upon termination of the trust or distribution of assets, the trustee may take a commission on principal distributed, including accumulated income which has been invested by the trustee. The amount of these paying commissions are as follows:

- If the distribution of the principal occurs within 5 years of the date when the principal is received by the trustee, an amount equal to the annual commissions on principal authorized under the statute but not actually taken by the trustee, plus 2% of the value of the principal distributed;
- If the distribution occurs between 5 and 10 years of the date when the principal is received by the trustee, an amount equal to the annual commissions on principal authorized under the statute but not actually received by the trustee, plus 1 1/2% of the value of principal distributed;

- If the distribution occurs more than 10 years after the date the principal is received by the trustee, an amount equal to the annual commissions on principal authorized under the statute but not actually taken by the trustee, plus 1% of value of principal distributed;
- If there are two or more trustees, their principal distribution commissions is the same as for a single trustee plus an additional amount of 1/5 of the commissions for each additional trustee.

The court may allow additional corpus commissions on a showing that unusual or extraordinary services were rendered by the trustee for which he should receive additional compensation.

New York

Sources: N.Y. SURR. CT. PROC. ACT §§ 2309, 2312, 2313 (1997 & Supp. 2008)
N.Y. EST. POWERS & TRUSTS §§ 11-A-5.1, -5.2 (Supp. 2008)

Summary[3]:

<u>Annual Commissions</u>: (chargeable 1/3 to income 2/3 to principal):

- $10.50 per $1,000 (1.05%) or major fraction thereof on first $400,000 of principal
- $4.50 per $1,000 (0.45%) or major fraction thereof on next $600,000 of principal
- $3.00 per $1,000 (0.30%) or major fraction thereof on all additional principal

<u>For collecting rents and managing real property</u>: 6% of the gross rents collected.

<u>Paying Commissions</u>:

1% of value of principal paid out (to be taken on settlement of accounting).

If a trustee is authorized or required by the terms of the will to accumulate income, the trustee is entitled to commissions from such income, including income from the investment of the accumulated income, at the rate of:

- 2% of the first $2,500 of such income distributed, and
- 1% of all such income distributed in excess of $2,500

<u>Increased Annual Commissions for Corporate Trustees</u>:

Corporate trustees are permitted (i) a higher statutory annual commission for trusts with a principal value of not more than $400,000 ($12.35 per thousand or major fraction thereof in lieu of the above rates) and (ii) reasonable commissions for trusts with principal value of more than $400,000.

If there are more than two trustees, no more than two commissions are allowed (different rules apply to trusts established before September 1, 1993).

Special rules apply to wholly charitable trusts.

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[3] Different rules apply to pre-1957 trusts.

Puerto Rico

Source: P.R. LAWS ANN. tit. 31, §§ 790, 2558 (1993)

Summary:

Trustees are entitled to receives the same fees allowed by law to guardians (tutors).

The compensation of tutors is fixed by the Superior Court, taking into account the consideration the amount of the estate and the labor which the administration of it requires.

Compensation for tutors can not be less than 4% nor more than 10% of the net income or proceeds of the property.