No.

IN THE

Supreme Court of the United States

WILLIAM L. RUDKIN TESTAMENTARY TRUST U/W/O HENRY A. RUDKIN, MICHAEL J. KNIGHT, TRUSTEE,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

There is a deep, irreconcilable and widely noted conflict among the Second, Fourth, Sixth and Federal Circuits about the meaning of 26 U.S.C. § 67(e) – which permits trusts and estates to deduct on their income tax returns certain administrative expenses – and whether the statute permits fees for investment management and advisory services to be fully deducted on trust's and estate's income tax returns. This is an important and recurring question of federal tax law that involves deductions by trusts and estates that total in the billions of dollars annually.

The Question Presented is:

Whether 26 U.S.C. § 67(e) permits a full deduction for costs and fees for investment management and advisory services provided to trusts and estates.

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PETITION FOR WRIT OF CERTIORARI

Michael J. Knight, Trustee of the William L. Rudkin Testamentary Trust, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Second Circuit (Petition Appendix ("App.") 1a-19a) is published at 467 F.3d 149. The decision of the Tax Court (App. 20a-30a) is published at 124 T.C. 304.

JURISDICTION

The judgment of the Court of Appeals was entered on October 18, 2006. App. 1a. A timely Petition for Rehearing was denied on January 19, 2007. App. 31-32a. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1).

RELEVANT STATUTORY PROVISION

Section 67(e) of the Internal Revenue Code, 26 U.S.C. § 67(e), provides in relevant part:

> For purposes of this section, 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. . .
>
> shall be treated as allowable in arriving at adjusted gross income.

INTRODUCTION

This case raises an important and recurring question of federal tax law that involves billions of dollars in annual deductible expenses and on which the courts of appeals are deeply and irreconcilably divided. The question is whether

fees for investment management and advisory services, sometimes called "investment advice" fees, may be deducted in full by trusts and estates when determining their taxable income. The dispute among the Circuits about this question has been called "perhaps the most vexing controversy currently outstanding" in the world of fiduciary income taxation,[1] and it has been widely noted, not only by courts, but in the literature as well.[2]

To give a sense of the importance of the tax treatment of the income and expenses of trusts and estates, trusts and estates reported over $85 billion of gross income in the most recent year for which statistics are available, filing almost four million income tax returns that year.[3] It can be estimated that over $1 trillion in assets are held in trusts and estates in the United States.[4] Many trustees utilize the services of professionals to provide investment management and advisory services. Internal Revenue Service (IRS) statistics

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[1] Janes, *Fiduciary Administrative Expenses: How Much Is Deductible?*, 32 Est. Plan. 21, 21 (2005).

[2] See, *e.g.*, Bell and King, *Sweeping Up the Two Percent Floor:* Scott v. United States *and the Deductibility of Investment Advisory Fees*, 38 Real Prop. Prob. & Tr. J. 589, 596 (2003) (describing the "classic split among the circuits").

[3] See Internal Revenue Service, *Statistics of Income Tax Stats – Income from Trusts and Estates* ("*IRS Tax Stats*"), at Table 3 (IRS 2005) (Fiduciary Income Tax Returns, Income, Deductions, and Tax Liability, by Tax Status, and Size of Gross Income, Filing Year 2004) available at http://www.irs.gov/pub/irs-soi/04fd03ts.xls.

[4] Over $1.1 trillion is held in personal trust and agency accounts alone in banks and trust companies in the United States. See FDIC, 2005 FDIC Trust Report and Table 1 (2006), available at http://www.fdic.gov/bank/individual/trust/report2005.html and http://www.fdic.gov/bank/individual/trust/table1.htm. In a recent year, decedents' gross estates valued individually at over $625,000 held in total $195.6 billion (measured at the time of the decedents' deaths). See Johnson and Mikow, *Federal Estate Tax Returns, 1998-2000* at 135 (IRS 2001), available at http://www.irs.gov/pub/irs-soi/00esart.pdf.

indicate that each year trusts and estates incur costs of several billion dollars in fees for such services.[5]

When an individual incurs such expenses, they are not fully deductible in calculating the individual's taxable income. Congress, however, has sought to provide preferential treatment for the expenses of administration and management of trusts and estates. 26 U.S.C. § 67(e) provides that:

> 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 . . . 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 . . . shall be treated as allowable in arriving at adjusted gross income.

26 U.S.C. § 67(e).

This beneficial rule for trusts and estates has two components. Its first prong requires that for an expense to be fully deductible it must have been "paid or incurred in connection with the administration of the estate or trust." Its second prong specifies that in order for that expense to be fully de-

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[5] See *IRS Tax Stats* at Table 3. The IRS does not publish data that precisely disaggregate these costs. For the most recently reported year, IRS data show a total of $5.6 billion in deductions on fiduciary income tax returns for a category known as "other deductions not subject to the two-percent floor." Id. Until the decision below was rendered, the largest component of that category was likely deductions for fees for investment advisory and management services. The data also show a total of $1.2 billion for what are called "allowable miscellaneous deductions." Under rulings of the Fourth and Federal Circuits described in more detail below, some trusts and estates categorized their fees for investment advice in that category, and, again, such fees were likely the largest single type of deduction within that category. Finally, the data show $3.9 billion deducted in that one year for trustees' and other fiduciaries' fees. Id. These fees, too, are primarily for investment advice and management. To the extent it is relevant to this case, these categories will be described more fully below.

ductible, it must also be one "which would not have been incurred if the property were not held in such trust or estate."

The Circuits are split 1-2-1 about the meaning of this second prong, and whether it permits fees for investment management and advisory services to be deducted in full by trusts and estates. "Because of the fiduciary obligations imposed on personal representatives and trustees, these conflicting decisions [of the courts of appeals] affect every trust and every estate that files an income tax return." Balter, *Second Circuit Holds Trust's Investment Advisory Fees ARE Subject to 2% Floor*, 32 Tax Mgmt. Est., Gifts & Tr. J. 136, 136 (2007).

The United States Court of Appeals for the Sixth Circuit has ruled that costs that "would not have been incurred if the property were not held in such trust or estate" include those costs that are imposed upon the trustee by his fiduciary duties. *O'Neill v. Comm'r*, 994 F.2d 302, 304 (CA6 1993). Consequently, it has held that investment management and advisory fees are fully deductible under § 67(e). Id. at 304-305. The United States Courts of Appeals for the Fourth and Federal Circuits have held that that statutory language covers only those costs that are not "of a type . . . commonly" or "customarily" incurred outside trusts. See *Mellon Bank, N.A. v. United States*, 265 F.3d 1275, 1281 (CAFed 2001); *Scott v. United States*, 328 F.3d 132, 139-40 (CA4 2003). Those Courts have held that under their test, such fees are not fully deductible under § 67(e).

Finally, in the decision below, the Second Circuit has advanced a third construction, holding that the statutory language permits a full deduction "only for those costs that could not have been incurred by an individual property owner." App. 13a. Applying this test, which it described as "more restrictive" than that adopted by the Federal and Fourth Circuits, id. 12a, the Second Circuit held that fees paid by trusts and estates for management and investment of assets are never fully deductible. Id. 19a.

This split in authority is untenable. It relates to an important and recurring problem and while it endures, the requirements upon federal taxpayers under the Internal Revenue Code vary from Circuit to Circuit. The decision below may cause the migration of trusts to, or the appointment of trustees located in, the Sixth Circuit or the Circuits where no decision on this question has been rendered in the hope that the Sixth Circuit rule will be followed in those Circuits. As this Court has long recognized, there are few areas of law in which the need for uniformity is as clear.

The financial impact of the decision below is also enormous, both in terms of the cost to the beneficiaries of trusts and estates, and to the financial services industry that provides these investment advice and management services.

Finally, this case presents an appropriate vehicle for the resolution of the split. The question presented was dispositive below and is cleanly and squarely presented. The issue has more than sufficiently percolated in the lower courts. Indeed, the Second Circuit's decision to coin a new test rather than adopting either the Sixth Circuit's approach or the interpretation of the Fourth and Federal Circuits indicates that further percolation may produce only greater conflict and confusion. Certiorari therefore should be granted.

STATEMENT

1. The William L. Rudkin Testamentary Trust ("Trust" or "Rudkin Trust") was established in 1967 under the will of Henry A. Rudkin, Sr. ("Rudkin" or "Henry Rudkin"). Rudkin, with his wife Margaret, founded Pepperidge Farm, maker of cookies and other food products. The Trust was funded with proceeds of the 1961 sale of Pepperidge Farm to the Campbell Soup Company. The Will and its First Codicil (the "Trust Documents") state that the Trust income and principal may be distributed by the Trustees of the Trust at their discretion for the "support, comfort, and education" of any or all members of the class comprising Rudkin's son William L. Rudkin, his wife or widow, and his descendants

and their spouses. App. 35a, 45a-46a. In addition, the Trust Documents specify that the principal may be distributed by the Trustees at their discretion "to advance the best interests of such member or members [of that class] in any business venture in which such member or members may be engaged or in which such members may wish to engage." App. 45a-46a.[6] At the beginning of the tax year at issue in this case, 2000, the Trust had assets worth $2,884,542.00.

The Trust is designed to last for generations. It expires twenty-one years after the death of the last survivor of Henry Rudkin's descendants living at the time of his death (or, if it occurs earlier, upon the deaths of William L. Rudkin and all of his descendants). App. 36a. The youngest of Rudkin's descendants who were living at the time of his death, Katharine Rudkin Allsopp, is now 46 years old. If she lives to be eighty, the Trust will not expire until 2063.[7]

The Trustees must comply with certain obligations in their management of the Trust assets:

•To begin with, the Connecticut Probate Court has appointed a guardian *ad litem* to protect the interests of the unborn beneficiaries of the Trust. See *Estate of Henry A. Rudkin*, Order of the Probate Court for the District of Fairfield, Fairfield Probate Court Records, Vol. 288, p. 644 (December 21, 1970). The Trustees are required to file a detailed principal and income trust accounting with the guardian and the Probate Court every three years. See Conn. Gen. Stat. § 45a-177.

•The Trust Documents do not provide any safe harbor for the Trustees in their decisions about investing the Trust assets. Rather the Trust Documents provide that the Trustees

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[6] The Trustees are also required to distribute portions of the trust principal to any persons or organizations designated by William L. Rudkin during his life or in his will if it was duly admitted to probate (except for William L. Rudkin himself or his estate or their creditors). App. 36a.

[7] Upon the Trust's expiration, its assets will be distributed to the living descendants of William L. Rudkin, *per stirpes*. App. 36a.

may "invest and reinvest the funds . . . in such manner as they may deem advisable without being restricted to investments of the character authorized by law for the investment of estate or trust funds." App. 38a.

•Further, the Trustees are subject to the Connecticut Uniform Prudent Investor Act. Conn. Gen. Stat. §§ 45a-541a to 45a-541*l*.[8] The Connecticut statute provides that "[a] trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements and other circumstances of the trust." Id. § 45a-541b(a).[9] It further specifies that "[a] trustee's investment and management decisions respecting individual assets shall be evaluated not in isolation, but in the context of the trust portfolio as a whole and as a part of an overall investment strategy having risk and return objectives reasonably suited to the trust." Id. § 45a-541b(b). The statute mandates the consideration by the Trustees in investing and managing of Trust assets of ten enumerated circumstances, including "the nature and estimated duration of the trust." Id. § 45a-541b(c).[10]

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[8] Since the completion of the Uniform Prudent Investor Act in 1994, versions of the uniform law have been adopted by 44 States and the District of Columbia as the standard for trust investment law. See Uniform Law Commission, A Few Facts About the Uniform Prudent Investor Act, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-upria.asp (last visited Mar. 23, 2007) (listing States).

[9] Of course, the common-law requirement of prudence in performance of a trustee's fiduciary obligations long antedates adoption of this statute. See *Harvard College v. Amory*, 9 Pick. 446, 461 (Mass. 1830).

[10] Conn. Gen. Stat. §§45a-541b(c) provides in full:

> Among circumstances that a trustee shall consider in investing and managing trust assets are such of the following as are relevant to the trust or its beneficiaries: (1) General economic conditions; (2) the possible effect of inflation or deflation; (3) the expected tax consequences of investment decisions, strategies and distributions; (4) the role that each investment or course of action plays within the overall trust portfolio, which may include financial assets, interests in closely held enter-

2. In order to comply with these obligations, the Trustees engaged Warfield Associates, Inc., ("Warfield"), an SEC registered investment advisor in New York, to manage the Trust assets.[11] Warfield charged the Trust an annual fee of 0.8% of Trust assets, billed quarterly. During 2000, Warfield charged, and the Trustees paid, quarterly fees totaling $22,241.31 for Warfield's services.

Trusts and estates, like individuals, must pay a tax upon their "taxable income." See 26 U.S.C. § 1. Trusts and estates must file a Form 1041, U.S. Income Tax Return for Estates and Trusts, called a fiduciary income tax return, whereas individuals must file the more well-known Form 1040.

On the Trust's Form 1041, the Trustees included a deduction for this full amount of Warfield's fees in calculating the Trust's taxable income. Taxable income for both individuals and trusts is derived, first, by taking "gross income," defined as "all income from whatever source derived," 26 U.S.C. § 61(a), and deducting in full certain expenses that are enumerated by statute (called "above-the-line" deductions) in order to arrive at a figure for "adjusted gross income." See 26 U.S.C. § 62(a). Taxable income is calculated by subtracting from "adjusted gross income" other deductions that are also enumerated by statute (these are called

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> prises, tangible and intangible personal property and real property; (5) the expected total return from income and the appreciation of capital; (6) related trusts and other income and resources of the beneficiaries; (7) needs for liquidity, for regularity of income and for preservation or appreciation of capital; (8) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries; (9) the size of the portfolio; and (10) the nature and estimated duration of the trust.

[11] The Trust Documents provide that the Trustees may "employ such agents, experts and counsel as they may deem advisable in connection with the administration and management" of the Trust. App. 41a. This delegation is expressly permitted by the Connecticut statute, see Conn. Gen. Stat. § 45a-541i(a).

"itemized" or "below-the-line" deductions). See 26 U.S.C. § 67(b) and Code sections cited therein. A subset of these itemized deductions, called "miscellaneous itemized deductions," however, has since the adoption of the Tax Reform Act of 1986 ("the 1986 Act") been deductible only to the extent that their aggregate "exceeds 2 percent of adjusted gross income." 26 U.S.C. § 67(a). These miscellaneous itemized deductions are, in other words, no longer fully deductible; in common parlance, the 1986 Act imposed a "two percent floor" on their deductibility.[12]

Individuals may not ordinarily deduct investment management and advisory fees in full from their gross income in order to calculate their adjusted gross income. Rather, under Treasury Regulations such fees are treated as "miscellaneous itemized deductions" that are subject to the two-percent floor. See Temp. Treas. Regs. § 1.67-1T(a)(1)(ii), 53 Fed. Reg. 9870, 9875 (Mar. 28, 1988); 26 CFR § 1.212-1(g); see also 26 U.S.C. § 212.

The Tax Code, however, has long given preferential treatment to the expenses incurred by trustees for the administration and management of trusts and estates, and in the same Section of the Code where it imposed the two-percent floor, Congress also provided in the 1986 Act that:

> 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 . . . the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which

[12] Congress limited the deductibility of these miscellaneous itemized deductions to relieve individual taxpayers and the IRS of the complexity and recordkeeping burdens that resulted when these deductions were allowed in full, and to prevent individuals from erroneously deducting expenses with "the characteristics of voluntary personal expenses" that lacked "sufficient business or investment purpose," for example, erroneous deductions for home office expenses, magazine subscriptions and safe deposit services. See H. Rep. No. 99-426 at 109-110 & n.8; S. Rep. No. 99-313 at 78-79 & n.18.

> would not have been incurred if the property were not held in such trust or estate . . . shall be treated as allowable in arriving at adjusted gross income.

26 U.S.C. § 67(e).[13] The Trustees deducted the fees paid to Warfield in full because they "would not have been incurred if the property were not held" in the Rudkin Trust.[14]

3. Respondent Commissioner disallowed this full deduction, permitting the Trust to deduct these fees only to the extent that they exceeded two percent of the Trust's adjusted gross income. He issued a Notice of Deficiency to the Trust in the amount of $4,448.[15]

Petitioner Trustee Michael J. Knight petitioned the Tax Court for a redetermination of deficiency. See 26 U.S.C. §§ 6212, 6213, 6214 and 7442. The Tax Court sustained the Commissioner's position. The court recognized that there is "a split in authority" among the courts of appeals on the issue of the deductibility of the costs of investment advice under § 67(e). It chose to follow its own previous decision in *O'Neill v. Commissioner*, 98 T.C. 227 (1992), even though that decision was reversed by the Sixth Circuit. See *O'Neill v. Commissioner*, 994 F.2d 302 (CA6 1993), rev'g 98 T.C.

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[13] The parties agree that fees paid for investment management and advisory services are "costs which are paid or incurred in connection with the administration of the estate or trust" within the meaning of the statute. See App. 6a; *Ungermann Trust v. Commissioner*, 89 T.C. 1131 (1983) (a very broad range of costs are included within the universe of administrative costs covered by this statutory language).

[14] The Trust listed these fees on a line on Form 1041, entitled "Other deductions not subject to the 2% floor." The Trust listed no miscellaneous itemized deductions subject to the 2% floor on the Form 1041 line for such items.

[15] The parties subsequently discovered an error in the calculation of adjusted gross income in the Trust's return, and they agree the correct number is $613,263, rather than the $624,816 listed on the return. The amount of the deficiency, though, was ultimately not altered by this correction. See App. 3a.

227 (1992).[16] As the Tax Court described, in *O'Neill* it held that

> the thrust of the language of section 67(e) is that only those costs which are unique to the administration of an estate or trust are to be deducted from gross income without being subject to the 2-percent floor on itemized deductions set forth at section 67(a). . . . Individual investors routinely incur costs for investment advice as an integral part of their investment activities. Consequently, it cannot be argued that such costs are somehow unique to the administration of an estate or trust . . . .

App. 26a-27a (quoting *O'Neill*, 98 T.C. at 230-231).

The Tax Court recognized that it had been reversed in *O'Neill* by the Sixth Circuit, which found that investment advice fees were fully deductible under § 67(e), see id. 27a, but noted that the decisions of the Federal Circuit in *Mellon Bank, N.A. v. United States*, 265 F.3d 1275 (CAFed 2001), and the Fourth Circuit in *Scott v. United States*, 328 F.3d 132 (CA4 2003), "diverged from the position taken by the Court of Appeals for the Sixth Circuit." Id. "Having reviewed our initial construction of section 67(e)," the Tax Court concluded, "and the ensuing judicial developments detailed above, this Court concludes that the interpretation set forth in [the Tax Court decision in *O'Neill*] and expressed by the Courts of Appeals in [*Scott*] and [*Mellon Bank*] remains sound." App. 29a.

4. Petitioner appealed to the Second Circuit. Before that court, the Commissioner conceded that "There is currently a split in the circuits regarding whether fees paid by trusts to

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[16] The Tax Court deems itself bound to follow the decisions of a Circuit Court of Appeals only when an appeal in the case before it lies to the same court of appeals. See *Golsen v. Commissioner*, 54 T.C. 742, 757 (1970). In cases in which the taxpayer is not a corporation, appeals from the Tax Court are taken to the Circuit in which the taxpayer legally resides. 26 U.S.C. § 7482(b)(1).

outside investment advisors are subject to the 2% floor." Brief for Appellee ("Gov't. CA2 Br.") at 3, *William L. Rudkin Testamentary Trust v. Commissioner*, 467 F.3d 149 (CA2 2006). The Commissioner argued that the court of appeals should reject the Sixth Circuit decision in *O'Neill*, and follow the decisions of the Fourth Circuit in *Scott* and the Federal Circuit in *Mellon Bank*. Id. 3-4, 22-24.

A two-judge panel of the Second Circuit affirmed, but on reasoning that differed from that of the Tax Court.[17] In an opinion written by Judge Sotomayor and joined by Judge Hall, the Second Circuit declined to follow either the Sixth Circuit or the Fourth and Federal Circuits.

The court began by canvassing "[t]he Circuit Split" on the question before it. App. 7a-9a. It determined that the Sixth Circuit had held that § 67(e) permitted a full deduction for costs caused by a trustee's fiduciary obligations, App. 7a (citing *O'Neill*, 994 F.2d at 304), and that the Fourth and Federal Circuits had held that only costs not "customarily" or "commonly" incurred by individuals were fully deductible. Id. 7a-9a (citing *Mellon Bank*, 265 F.3d at 1280-81 and *Scott*, 328 F.3d at 139-40).

The Second Circuit then rejected each of the interpretations put forward by its sister Circuits. Despite the statutory phrase describing costs "which would not have been incurred if the property were not held in such trust or estate," the court concluded that "nothing in the statute indicates the Congress intended to make applicability of the deduction dependent on what costs are peculiarly incurred by a specific trust." App. 13a. Rather, the court concluded that the "plain meaning" of that phrase "excludes from full deduction those costs of a type that *could* be incurred if the property were held individually rather than in trust." App. 11a (emphasis in original). "We . . . hold that the plain meaning of the statute permits a trust to take a full deduction only for those costs

[17] Judge Feinberg, who was originally on the panel, recused himself after oral argument. See App. 2a n.*.

that could not have been incurred by an individual property owner." App. 13a.

Applying this test, the court ruled, contrary to the Sixth Circuit, 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.

App. 12a. The court also made clear that it "disagree[d]" with the Federal and Fourth Circuits, stating that it was adopting a "more restrictive" reading of the statute than they had. App. 12a.[18]

The court asserted that even if the meaning of the statute were not plain, "canons of statutory interpretation favor[ed]" its conclusion because "when the statute is ambiguous, we resolve interpretive disputes as to the availability of a tax deduction in favor of the government." App. 14a. Finally, the court asserted that, because it had found the language of

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[18] In reaching its conclusion about the meaning of the statute, the court expressly declined to rely upon legislative history upon which the Federal Circuit had relied, noting that it "predate[d] the introduction of § 67(e)(1)'s second clause." App. 15a n.4; cf. *Mellon Bank*, 265 F.3d at 1281. It also "did not adopt the Federal and Fourth Circuit's view" that reading the statute to permit the deduction of investment advice fees would render that second clause superfluous because it would mean that all administrative costs were fully deductible. App.18a-19a n.7. See *infra* at 24-25 & n.24.

the statute unambiguous, it did not need to address its legislative history. But it asserted that, in any event, nothing in that legislative history "supports the Trust's proposed interpretation of the statute . . . or provides any reason to depart from our reading of the statute's meaning." App. 15a.

5. The court of appeals denied rehearing and rehearing en banc. App. 31a-32a. This Petition followed.

REASONS FOR GRANTING THE PETITION

There is a deep, untenable and well-recognized division among the Circuits concerning the meaning of 26 U.S.C. § 67(e). It is a recurring question of enormous practical importance and financial consequence, and this case presents an ideal vehicle for its resolution.

I. THERE IS AN ACKNOWLEDGED, IRRECONCILABLE, AND UNTENABLE DIVISION AMONG THE CIRCUITS ABOUT THE DEDUCTIBILITY BY TRUSTS AND ESTATES UNDER 26 U.S.C. § 67(e) OF FEES FOR INVESTMENT MANAGEMENT AND ADVISORY SERVICES.

A. The Circuits Are in Acknowledged and Irreconcilable Conflict Regarding the Deductibility of Expenses by Trusts and Estates Under § 67(e).

1. The Sixth Circuit.

The Sixth Circuit holds that fees for investment advice and management services are fully deductible by trusts and estates since they are incurred because of the trustees' fiduciary responsibilities. In *O'Neill v. Commissioner*, 994 F. 2d 302, 304 (CA6 1993), the court addressed a trust the trustees of which, themselves having no expert knowledge in the investment of large sums of money, had hired an investment advisor to manage and invest the trust's assets. There the court held that "investment advisor fees paid by the Trust were costs incurred because the property was held in trust, thereby making them eligible for the § 67(e) exception and not subject to the" two-percent floor. Id. at 304. The court reasoned that because the fees had been caused by the fiduci-

ary duties of the trustees, they "would not have been incurred if the property had not been held in trust:"

> A trustee is charged with the responsibility to invest and manage trust assets as a "prudent investor" would manage his own assets. . . . Where a trustee lacks experience in investment matters, professional assistance may be warranted. The trustees here lacked experience in investing and managing large sums of money and, therefore, sought the assistance of an investment advisor. . . . [T]he investment advisory fees were necessary to the continued growth of the Trust and were caused by the fiduciary duties of the co-trustees.

Id.[19]

2. The Fourth and Federal Circuits.

The Fourth Circuit and the Federal Circuit reject the Sixth Circuit's position and hold that § 67(e) does not permit the full deduction of fees for investment management and advice by trusts and estates because they are expenses "of a type . . . commonly" or "customarily" incurred outside trusts. See *Mellon Bank, N.A. v. United States*, 265 F.3d 1275, 1280-1281 (CAFed 2001); *Scott v. United States*, 328 F.3d 132, 139-140 (CA4 2003).

In *Mellon Bank*, the Federal Circuit held that fees for investment advice were subject to the two percent floor under the "plain meaning" of the statute. The court reasoned that "[a]ll expenses resulting from the fiduciary obligations of the trustee" satisfy the first prong of § 67(e), *i.e.*, that they are all "costs which are paid or incurred in connection with the administration of the estate or trust." Id. at 1280. The Com-

[19] Fiduciaries, the court went on "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." Id. They differ in this regard, the court noted from individual investors who "are not *required* to consult advisors and suffer no penalties or potential liability if they act negligently for themselves." Id.

missioner conceded, as he did in this case, that "trustee fees are fully deductible." Id. at 1279. Appellant Mellon Bank argued that "[s]ervices delegated by the trustee remain subject to fiduciary standards and are fiduciary services under governing law," and that therefore payments for such services, too, were fully deductible. Id.

The Federal Circuit reasoned that if this were correct "all expenses incurred by a trustee in connection with the administration of a trust would be fully deductible." Id. at 1280. This, the court concluded, would read out of the statute the "second prong" of § 67(e) – the requirement that only administrative costs that "would not have been incurred if the property were not held in such trust or estate" are fully deductible. Id.

In an attempt to craft an interpretation that would "give full effect" to the statute and not render any of its language superfluous, the court asserted that the second prong of § 67(e) "focus[ed]" on "the type of costs" at issue. Id. at 1281. It concluded that "the second requirement 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." Id.

> Investment advice and management fees are commonly incurred outside of trusts. An individual taxpayer, not bound by a fiduciary duty, is likely to incur these expenses when managing a large sum of money. Therefore, these costs are not exempt under section 67(e)(1) and are required to meet the two percent floor of section 67(a).

Id.

The *Mellon Bank* decision was followed by the Fourth Circuit in *Scott*. Noting that "[o]ur sister circuits have split over the proper resolution of the legal issue here," 328 F.3d at 135, the Fourth Circuit concluded "we find ourselves in agreement with the Federal Circuit's reasoning in *Mellon Bank*, and thus render a decision at odds with the Sixth Cir-

cuit's holding in *O'Neill*," the analysis in which, the court concluded, "contains a fatal flaw." Id. at 140.

The Fourth Circuit concluded that the language of the statute was "clear and unambiguous." Id. at 139. It stated that "[t]he verb 'would' in the context of § 67(e)(1) expresses concepts such as custom, habit, natural disposition, or probability." Id. at 139 (citing Webster's Third New International Dictionary 481 (1976) and American Heritage Dictionary of the English Language 2042, 2059 (3d ed. 1992)).

> Thus, "the second requirement 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." *Mellon Bank*, 265 F.3d at 1280-81; *see also Mellon Bank, N.A. v. United States*, 47 Fed. Cl. 186, 188-89 (Fed. Cl. 2000). Put simply, trust-related administrative expenses are subject to the 2% floor if they constitute expenses commonly incurred by individual taxpayers.

Id. at 139-140.

Applying this test, the court asserted that "investment-advice fees are commonly incurred outside the context of trust administration," and held the fees not deductible. Id. at 140. The court concluded that "holding that a trust's investment-advice fees were fully deductible" would "render meaningless the second requirement of § 67(e). . . . To give effect to this limitation, we must hold that the investment-advice fees incurred by the Trust do not qualify for the exception created by § 67(e). Rather, they are subject to the 2% floor established by § 67(a)." Id.

3. The Second Circuit.

Finally, the Second Circuit has now rejected the positions of the Fourth, Federal and Sixth Circuits, holding that fees for investment management and advisory services are not deductible by trusts and estates under § 67(e) regardless of

how "commonly" they are incurred outside of trusts and estates, because they are costs of a type that "could be" incurred by an individual taxpayer. App. 11a.

The court below explicitly acknowledged the split among the Circuits. App. 7a-9a. It noted that the Sixth Circuit had "held that 'the investment advisor fees paid by the Trust were costs incurred because the property was held in trust, thereby making them eligible for the § 67(e) exception and not subject to the base of two percent of adjusted gross income.'" App. 7a (quoting *O'Neill v. Comm'r*, 994 F.2d 302, 304 (CA6 1993)). The Sixth Circuit's *O'Neill* decision, the Second Circuit said, "established the rule that a trust's costs attributable to the trustee's fiduciary duty, and not required outside the administration of trusts, fall within the § 67(e)(1) exception and are therefore fully deductible." Id.

The Federal Circuit, the court went on, "rejected this reasoning." Id. In *Mellon Bank*, the Second Circuit explained, the Federal Circuit held that the statute "'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,'" and concluded that "because '[i]nvestment advice and management fees are commonly incurred outside of trusts,'" they are not fully deductible when incurred by trusts, but are subject to the two-percent floor. Id. 8a (quoting *Mellon Bank*, 265 F.3d at 1281).

Finally, the court below recounted, the Fourth Circuit had held that "trust-related administrative expenses" are not fully deductible "if they constitute expenses commonly incurred by individual taxpayers," concluding "that because investment-advice fees are commonly incurred outside the context of trust administration, they are subject to the two-percent floor." Id. (quoting *Scott*, 328 F.3d at 139-40).

The Second Circuit then rejected both the rule articulated by the Sixth Circuit in *O'Neill*, and that adopted by the Fourth and Federal Circuits in *Scott* and *Mellon Bank*. After concluding that "the second prong of § 67(e)(1) does not ask

whether the costs at issue . . . are incurred as a result of a particular trustee's fiduciary duty," id. 11a, the court held "that the plain meaning of the statute permits a trust to take a full deduction only for those costs that could not have been incurred by an individual property owner," id. 13a, and that fees for investment advice therefore were not fully deductible. And it noted explicitly its disagreement not only with the Sixth Circuit, but with the Federal and Fourth Circuits as well:

> We . . . join the Federal and Fourth Circuits in holding that § 67(e)(1) does not exempt from § 67(a)'s two-percent floor investment-advice fees incurred by trusts. We disagree, however, with their statement that costs 'not *customarily* incurred outside of trusts' are the ones not subject to the floor, *Mellon Bank*, 265 F.3d at 1281 (emphasis added); *Scott*, 328 F.3d at 139-40 (citing *Mellon Bank* and stating that § 67(e)(1) subjects 'expenses *commonly* incurred by individual taxpayers' to the two-percent floor (emphasis added)), because. . . we believe § 67(e)(1) is more restrictive than that.

Id. 12a.

B. The Conflict Among the Circuits on this Issue Is Untenable and Presents Particularly Serious Problems for the Administration of the Revenue Law.

This split among the Circuits is untenable. This Court has long recognized the special need for uniform rules with respect to federal taxation. See, *e.g.*, *Commissioner v. Bilder*, 369 U.S. 499, 501 (1962) (Harlan, J.) (need for a uniform rule about a specific deduction in the face of division among the courts of appeals warrants grant of certiorari). Here the difficulty with the conflict is exacerbated both by the nature of the fees at issue and the scope of the jurisdiction of the various courts of appeals.

While this Circuit conflict endures, taxpayers in identical circumstances living in different Circuits will be subject to

different federal tax laws and will face different federal tax obligations. Tax Court appeals lie to the court of appeals for the Circuit in which the taxpayer, the trustee in these cases, has legal residence. See 26 U.S.C. § 7482(b)(1). Further, until the legal issue in this case is resolved, this recurring question will generate continuing disputes in Circuits that have not yet ruled on the issue. Treasury Regulations provide that there is no penalty for taking a position in one's tax return, even one that is not ultimately sustained, so long as there is "substantial authority" for that position. See 26 CFR § 1.6662-4(a), (d). Under those regulations, the Sixth Circuit's *O'Neill* case provides substantial authority for the proposition that trusts and estates may deduct in full fees for investment advice and management, notwithstanding the decisions of the Second, Fourth and Federal Circuits. Thus, despite the Commissioner's position on this issue, trustees in the Circuits that have not ruled on this issue are likely to continue to treat these fees as deductible in full, resulting in more enforcement, litigation, and uncertainty costs. See, *e.g.*, Levin, *Limitation on Deductions for Trusts: What Should a Trustee Do?* ("Levin"), 111 Tax Notes 445, 445-447 (Apr. 24, 2006) (urging that trustees in these Circuits should take this deduction in full).

There is thus also a substantial risk of funds migrating to the Sixth Circuit from the Second Circuit in light of the decision below, or of trusts seeking to add trustees not resident in the Circuits that have rendered unfavorable decisions. Indeed, the single largest holder of trust assets in New York[20] has already advised its customers in the wake of the decision below that, while investment advice fees will be subject to the two-percent floor if that bank is the sole trustee, "if there are any co-trustees who reside outside the Second, Fourth or Federal Circuits, we ask that for 2006 you do not apply the 2% limitation if there are any applicable expenses." Letter

[20] See FDIC, 2005 FDIC Trust Report, Table 4 (2006), available at http://www.fdic.gov/bank/individual/trust/table4.htm.

of A. Dean Theiss, Jr., Vice-President & Manager Fiduciary Specialized Services, JPMorgan Private Banking, JPMorgan Chase & Co., February 21, 2007, reprinted at App. 49a-52a.

II. THIS RECURRING ISSUE IS ONE OF FUNDAMENTAL IMPORTANCE TO TRUST BENEFICIARIES AND THE FINANCIAL SERVICES INDUSTRY.

The magnitude of this issue and its practical importance reinforce the conclusion that certiorari is warranted. As described above, fees incurred by trustees for investment advice and management can be estimated to total in the billions of dollars each year. The defining feature of a trust (or an estate), of course, is its division of title to the property into separate legal and equitable interests. The legal interest is held by the trustee, but the equitable interest is held by the beneficiaries. And while these fees are paid by the trustees, those most directly harmed are trust and estate beneficiaries of all kinds, be they an individual's surviving family members, as in this case, individuals unable to manage their own affairs, through age, disability or the like, or, in the case of estates, beneficiaries named in a will.

Subjecting these fees to the two-percent floor increases the tax liability of a trust or estate. Ultimately this reduces the size of the trust corpus – and its future earnings over time. And, if the ruling below is allowed to stand, trust assets will be reduced not just once, but annually. Cf. Janes, *Fiduciary Administrative Expenses: How Much Is Deductible?*, 32 Est. Plan. 21, 22 (2005) (noting that if these fees are subject to the two percent floor there can be "a sizable loss of deductions"). The resolution of this question therefore is of profound significance to current and potential trust settlors and beneficiaries – and, in light of the amount of tax revenue involved, to the United States.

The financial services industry, too, is seriously affected by the legal issue in this case. The split in authority that was deepened by the decision below may have serious consequences for the financial services industry in New York, as

trustees, settlors and beneficiaries seek ways to avoid the two-percent floor that may include abandonment of New York-based trustees in favor of trustees located elsewhere in the country. Financial services companies are typically chosen both to serve as trustees and to provide management and advisory services for those trusts; individual trustees in the Second Circuit also typically obtain investment management and advisory services from financial services companies in the Circuit, particularly in New York.

Even apart from the incentives created by the lack of nationwide uniformity, the decision below could have serious consequences for this sector of the economy. Under the Second Circuit's decision, trustees will have an interest in attempting to fulfill their fiduciary responsibilities of prudent investment without incurring investment management and advice fees subject to the two-percent floor. This would be bad for the financial services industry and for those for whom trust assets are held.

Some, particularly smaller trusts, may take their assets out of management and attempt to invest them in mutual funds, the costs of which are always deductible. See 26 U.S.C. § 67(c)(2). Others may try to use brokers, who typically charge nothing for their advice, but only commissions for purchases and sales, which are included in the cost basis for securities and deducted from the gain upon sale such that they are effectively excluded from taxable income, see 26 CFR § 1.263(a)-2(e). Many will also likely seek trustees who are themselves skilled in investment, so that no separate investment advice and management fee need be incurred. This is an approach that has been described repeatedly in the literature.[21] The Commissioner takes the position that under

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[21] See, *e.g.*, Satchit, *Estates, Trusts & Gifts: Trusts, Investment Advisory Fees and the 2% Floor*, Tax Adviser, Feb. 2004 at 87, 88; Hohos, *Fees Paid By Trustees For Investment Strategy Advice and Management Services are not Deductible Under Section 67(e)(1):* Mellon Bank, N.A. v. United States, 54 Tax Law. 693, 699 (2001).

§ 67(e) "[t]rustee's fees" are not subject to the two-percent floor. See Gov't. CA2 Br. at 24. Trustees, though, are paid primarily to manage trust assets, something reflected in the fact that such fiduciary fees totaled $3.9 billion in 2004, the last year for which data is available.[22] The concern of the financial services industry about the decision below can be seen in the steps already being taken by some banks to address that decision while retaining their trust clients. See App. 49a-51a.

III. THE READING GIVEN THE STATUTE BY THE COURT BELOW IS CLEARLY IN ERROR.

A. The Second Circuit's Interpretation of the Statutory Language is in Error; Under its Most Natural Reading, the Statute Permits the Deduction in Full of Fees for Investment Management and Advisory Services.

1. While certiorari thus should be granted regardless of what position on the merits is correct, in fact, the construction given the statute below is clearly in error, and requires reversal. Section 67(e) provides that the trust's administrative expenses are fully deductible so long as they "*would* not have been incurred if the property were not held in such trust or estate." 26 U.S.C. § 67(e) (emphasis added). The Second Circuit held that "the plain meaning of the statute permits a trust to take a full deduction only for those costs that *could*

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[22] See *IRS Tax Stats* at Table 3 (IRS 2005), available at http://www.irs.gov/pub/irs-soi/04fd03ts.xls. The Commissioner has suggested that he has "authority to require trustees to 'unbundle' their fees" presumably to determine what portion of them might be attributable to investment management and advice. See Gov't. CA2 Br. at 56. The Commissioner, however, has never issued regulations requiring disaggregation of such fees, despite his longstanding position that fees for investment advice and management are subject to the two-percent floor. The burden upon the IRS and the taxpayers of evaluating the proportion of such fees attributable to investment advice and management in each case, including the enormous difficulty that would be involved in auditing this question, is another substantial cost that would be imposed if the statute were consistently read as the Commissioner urges.

not have been incurred by an individual property owner." App. 13a (emphasis added).

This is wrong and the court's reasoning cannot withstand scrutiny. Asking whether something "would not" have been incurred is not the same as asking whether it "could not" have been incurred. Not even the Commissioner urged this construction upon the court below. See Gov't. CA2 Br. at 22-24 (urging the court to adopt the *Mellon Bank*/*Scott* reading of the statute). The Second Circuit's construction is plainly in error.

The best reading of the statute simply tracks its language: "[C]osts 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 . . . shall be treated as allowable." 26 U.S.C. § 67(e). The fees at issue here, for advice on how to invest Rudkin Trust assets consistent with the purposes of that trust "would not have been incurred if the property were not held in such trust." That is the end of the matter. These fees, therefore, should be fully deductible.

2. This reading does not render the second prong of § 67(e) superfluous. There are, indeed, administrative costs that a trustee can incur that would have been incurred even if the property were not held in the trust at issue. The primary example of these are administrative costs that are passed through to the trust from so-called pass-through entities. Pass-through entities include partnerships and S corporations. Such entities do not pay income tax themselves, but "pass through" their income, deductions and credits, which are reported by their ultimate owners. See, *e.g.*, 26 U.S.C. § 701 ("A partnership as such shall not be subject to the income tax imposed by this chapter. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.")

Pass-through entities can be abused because the tax law may allow them to claim on their own tax returns deductions

in full that would, if taken directly by their owners, have been subject to the two-percent floor. These deductions would be passed through to their owners on the form used by the pass-through entity to report to its owners their share of income and deductions.

The 1986 Act included a provision to restrict the ability of individuals to indirectly deduct expenses of pass-through entities in this way to avoid the two-percent floor. See 26 U.S.C. § 67(c).[23] The second prong of § 67(e) effects a parallel restriction on trusts and estates. If a trust were a partner or shareholder in a pass-through entity, that entity could incur expenses in its administration, and pass them through to the trust, reporting them as deductions on the tax form sent to the trust. The trust could then record them as administrative expenses on its tax return. But in most circumstances these expenses "would . . . have been incurred" regardless of whether the interest in the pass-through entity was or was not "held in such trust or estate." When an individual owns an interest in a pass-through entity, these costs are subject to the two-percent floor. The second prong of § 67(e) makes clear that when a trust owns an interest in a pass-through entity, these costs may also be subject to the two-percent floor. Indeed, the legislative history of that second prong confirms that this was its primary purpose. See H.R. Conf. Rep. No. 99-841, pt. 2, p. 34 (1986), *reprinted at* 1986 U.S.C.C.A.N. 4075, 4122.[24]

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[23] 26 U.S.C. § 67(c) provides in relevant part: "The Secretary shall prescribe regulations which prohibit the indirect deduction through pass-thru entities of amounts which are not allowable as a deduction if paid or incurred directly by an individual and which contain such reporting requirements as may be necessary to carry out the purposes of this subsection."

[24] In both the original House and Senate versions of the bill, § 67(e) did not contain a second prong. In both versions, it read simply "For purposes of this section, 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 deductions for costs paid or incurred in connection with the admini-

B. There is No Basis for Reading the Statute as the Fourth and Federal Circuits Have.

In the absence of a superfluity problem, there is no basis for adopting the *Mellon Bank* court's reading of § 67(e) as asking about different "types" of expenses. The statute does not ask if expenses are like those that are incurred by individuals. It asks about the specific expenses incurred by the particular trust that is claiming the deduction: Are they "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, while the *Scott* court is correct that the word "would" is sometimes used "to expres[s] concepts such as custom, habit, natural disposition or probability," 328 F.3d at

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stration of the estate or trust shall be treated as allowable in arriving at adjusted gross income." See H.R. 3838 (99th Cong., 1st Sess, Dec. 17, 1985) (House version); H.R. 3838 (99th Cong. 2d Sess., May 29, 1986) (Senate version). The second prong was added in the Conference Committee. Its legislative history, therefore, lies solely in the Conference Report, which makes clear that Congress had in mind preventing estates and trusts from indirectly deducting administrative costs of pass-through entities:

> Pursuant to Treasury regulations, the floor is to apply with respect to indirect deductions through pass-through entities . . . In the case of an estate or trust, the conference agreement provides that the adjusted gross income is to be computed in the same manner as in the case of an individual, except that the deductions for costs that are paid and incurred in connection with the administration of the estate or trust and that would not have been incurred if the property were not held in such trust or estate are treated as allowable in arriving at adjusted gross income and hence are not subject to the floor. The regulations to be prescribed by the Treasury relating to application of the floor with respect to indirect deductions through certain pass-through entities are to include such reporting requirements as may be necessary to effectuate this provision.

H.R. Conf. Rep. No. 99-841, pt. 2, p. 34 (1986), *reprinted at* 1986 U.S.C.C.A.N. 4075, 4122.

139, that is obviously not the sense in which it is used here. See, *e.g.*, Merriam-Webster Collegiate Dictionary 1445 (11th ed. 2003) (giving as an example of the use of the word "would" to "express custom or habitual action" the phrase "we would meet often for lunch"); Webster's New International Dictionary of the English Language 2955 (2d ed. 1956) (describing the use of "would" to describe custom or habit as a "special use"). The statute is not asking about what happened in the past customarily or habitually. It is asking concretely with respect to "the" particular trust or estate whether the administrative expense at issue is one "which would not have been incurred if the property were not held in such trust or estate."

Further, determining what expenses are "customarily" or "commonly" incurred by individuals opens up a judicially unmanageable inquiry that Congress could not have intended. Are management fees "commonly incurred" by individuals? Common experience suggests that they are not. To begin with, even moderately wealthy individuals rarely hire investment management professionals to manage their portfolios. Providers of such services ordinarily won't even accept clients with assets below some high threshold. And most individuals invest primarily in mutual funds or in individual stocks that they pick themselves or that are recommended by their broker, paying only commissions and not advisory fees. Petitioner argued below that, even if the court adopted the customary-individual-cost test articulated in *Scott* and *Mellon Bank*, fees for investment management and advice do not meet it. The Second Circuit did not reach this alternative argument for reversal after it rejected the position taken by the Fourth and Federal Circuits.

More broadly, if determining whether a cost "would not have been incurred if the property were not held in such trust or estate" requires examining what an individual with such property would "commonly" or "customarily" have done, the answer will differ from case to case depending, among other things, on the amount and type of the property held in trust.

Nor is it at all clear upon what evidence a court could hope to rely in answering the question what costs individuals "customarily" incur in the myriad variable fact patterns that will be presented by different trusts.

Nor does the Commissioner even apply this "common" or "customary" costs approach consistently. The Commissioner concedes, for example, that costs for "the preparation of fiduciary income tax returns" are fully deductible under § 67(e). See Gov't. CA2 Br. at 24. The courts of appeals that have sustained his position about investment management and advisory fees have all agreed with this reading of the statute. See, *e.g.*, App. 12a; *Scott*, 328 F.3d at 140. Yet tax return preparation fees are costs of a "type" commonly incurred by individual taxpayers in the millions every tax season. "Income tax return preparation fees . . . are not unique to trusts or estates." Levin, 111 Tax Notes at 453. Regardless of who owned the property held in a trust, a tax return reporting income it has generated would have to be prepared and filed.

The Commissioner concedes, too, that "[t]rustee's fees" are fully deductible, see *supra* at 22-23, a conclusion with which the courts of appeals that have sustained his position have also agreed. *E.g.*, App. 12a. But again, trustees are paid primarily to manage trust assets. In this case, where the Trustees lacked the expertise to make investment decisions for the Trust, they delegated those functions to Warfield – and did not take any deduction for trustee fees.

Under the Commissioner's reading, where a trustee makes the investment decisions himself, the trust may deduct the fees that trustee has charged for managing the trust assets; but where those decisions are delegated, the fees charged for managing the trust assets may not be deducted. Congress surely cannot have intended such a result.

IV. THIS CASE PRESENTS AN APPROPRIATE VEHICLE FOR RESOLUTION OF THIS SPLIT.

Finally, this case presents an appropriate vehicle for addressing the question that divides the Circuits. This Court routinely grants certiorari to resolve conflicts among the Circuits concerning federal tax law in cases in precisely this procedural posture, where a court of appeals has affirmed a Tax Court position to which it adhered after another court of appeals has reversed it on the same question. See, *e.g.*, *Commissioner v. Estate of Hubert*, 520 U.S. 93, 99 (1997); *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 206-207 (1990). In this case, the Second Circuit's erroneous reading of § 67(e) was dispositive. This case thus cleanly presents the legal issue in dispute and this case therefore presents an appropriate vehicle for resolution of the Question Presented. (Indeed, because the court below did not reach Petitioner's alternative argument below that the test of *Scott* and *Mellon Bank* was not met here, even if this Court were to disagree with Petitioner's proffered interpretation of the statute and agree with that put forward in those cases, reversal of the judgment below would be required.) There is certainly no need for further percolation of this issue. Indeed, the Second Circuit's decision to utilize its own test rather than adopting that of the Sixth or that of the Fourth and Federal Circuits indicates that additional court of appeals decisions on this question may produce only greater conflict and confusion.

Clarifying this issue now will also be particularly useful in assisting those subject to, and those who must enforce, this federal tax law. Although the aggregate amounts at stake are enormous and both the bench and bar require the guidance of this Court, because of the high cost of litigation, individual taxpayers denied this full deduction will ordinarily have insufficient incentive to pursue appeals. In this case, for example, the tax deficiency alleged for the one year at issue is only $4,448.00. Thus, while the issue clearly is a recurring one, deciding this issue now rather than later will

be of enormous benefit to innumerable taxpayers who would otherwise face this question without its resolution, as well as to the federal government.

Lastly, because New York is home to such a significant part of the financial services industry and, indeed, to such a significant portion of this nation's wealth, the decision by the Second Circuit that trusts and estates may not fully deduct investment advisory and management fees will have a more serious impact than would such a decision by any other court of appeals. This renders the need for review of the Question Presented in this case even more urgent.

CONCLUSION

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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