The court rejected their arguments, noting that if the statute prohibited only a loan or loan guaranty between a disqualified person and the IRA itself, the prohibition could be easily avoided by having the IRA create a shell subsidiary or other intermediary.

Daley case — taxpayer wins

Language in a debtor's contract with an investment firm that granted the firm a lien on his IRA did not create a disallowed extension of credit that would have allowed the debtor's Chapter 7 bankruptcy proceedings to attach the IRA assets to satisfy the claims of creditors.[7]

James Daley opened an IRA account with Merrill Lynch and signed a "Client Relationship Agreement." As part of that agreement, Daley gave Merrill Lynch a lien on the IRA account that Merrill Lynch could use to satisfy any debts that Daley owed to Merrill Lynch, either relating to the IRA account or to any other account that Daley might open with the firm.

Daley never opened another account with Merrill Lynch and no debts in connection with Daley's relationship with the firm were ever incurred. Daley never withdrew money from the IRA account.

Two years after opening the account, Daley filed a Chapter 7 bankruptcy. He invoked the Bankruptcy Code provision that allows IRAs to be excluded from the bankruptcy estate. However, the bankruptcy trustee objected, arguing that the IRA lost its exempt status when Daley signed the agreement granting a lien to Merrill Lynch. The bankruptcy court and the district court agreed with the trustee's position.

However, the Sixth Circuit reversed, finding that the phrase "any direct or indirect … lending of money or other extension of credit,"[8] while broadly worded, still required an actual loan or extension of credit and Daley had never borrowed from the IRA and Merrill Lynch had never loaned money to Daley based on his having established an IRA with the firm. The court stated that, while a lien may sometimes be granted as collateral in connection with a loan, that didn't mean that a loan had actually occurred.

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1 ***Ellis v. Comm.***, TCM 2013-245

2 See IRC §4975(e)(2)(G); and relying on ***Swanson v. Comm.*** (1996) 106 TC 76, 88

3 IRC §408(e)(2)

4 IRC §4975(c)(1)

5 See IRC §4975(e)(2) for the definition of a disqualified person

6 ***Peek and Fleck v. Comm.*** (2013) 140 TC 12

7 ***Daley v. Mostoller*** (2013) Court of Appeals for the Sixth Circuit, Case No. WL 2922651

8 IRC §4975(c)(1)(B)

Solo or co-trustees or co-executors? It depends on the family

TRUSTS: Weigh the pros and cons of having only one trustee, or multiple.

By Richard B. Malamud, CPA, J.D., LL.M.
Guest Contributor

How many times have you dealt with a family trust where all of the adult kids are named co-trustees? Even if the kids currently get along, it may have been better if there were only one trustee, as co-trustees often result in fights, and worse: siblings who no longer speak to one another after the trust's assets are distributed and their trustee obligations end.

The reason for this desire to have a sole trustee is complicated and may not apply to all families. In those cases where the trustees don't get along, there are both legal and family issues. If there are two trustees, what happens if they don't agree? If there are three, does a majority control, or must all three (or more) agree?

States have different rules, so when the disagreement arises, they will have to either research the law, hire an attorney, or worse — do what they think is right, which may provoke a costly and time-consuming intra-family lawsuit in which only the lawyers win.

In a recent New York case, dad left an apartment to his son and daughter as co-trustees. The daughter lived there and supposedly managed the property. She was unable to maintain the property, leading to unsanitary conditions which resulted in lost rents. In addition, she was hostile to her co-trustee brother. The court removed her as co-trustee.[1] This could have easily been avoided if the son had been the sole trustee. It would have probably been no worse if the daughter had been sole trustee, as the same lawsuit would probably have been filed.[2]

State law controls

The process by which co-trustees make decisions is based on state law if the trust doesn't specify otherwise. Typically, when there are two trustees, they must act unanimously[3] and each co-trustee must "… take reasonable steps to prevent a co-trustee from committing a breach of trust … ."[4] In rare cases, one trustee can act: "[I]f a cotrustee is unavailable to perform the duties … because of absence, illness, or other temporary incapacity, the remaining cotrustee or cotrustees may act for the trust, … where necessary to accomplish the purposes of the trust … ."[5] If they can't agree, either or both can file a Court petition for instructions.[6]

The effect is that each trustee has a veto power: "If you don't agree to give me Dad's car, I won't agree to give you Mom's jewelry." It escalates from there. Going to court to resolve the dispute is often more costly and time-consuming than it is worth.

In many states, if there are three trustees, a majority is all that is needed to make a decision. In California, "… a power vested in two or more trustees may only be exercised by their unanimous action"[7] unless the trust states otherwise. Do three people ever agree on anything? Although this was the common law rule, the trend in Restatement (Third) of Trusts §39 and the Uniform Trust Code §703 is to allow a majority vote. Many states have adopted that provision.[8]

One trustee more efficient

It not only makes sense to have one trustee to prevent fights between siblings, it also can speed up the process as one person is often more efficient than two. The meetings alone can delay the process even if the trustees get along. This is the case when they live in different cities, or even if they live in a metropolitan area like Southern California where the traffic makes meetings problematic.

This same logic applies also to health care directives. Two or three is not better than one. It is hard enough to decide when to stop providing life-extending services. It is even harder if two or more children have to agree. One may want to end the suffering while the other may not be ready to act. Neither is right or wrong, as we all deal with these decisions differently. In the case of health directives, it is important to name a contingent person in case the primary one is out of town when a decision has to be made. With trustees, successor trustees should be named in case there is a resignation or death of the initial trustee.

Multiple trustee sometimes preferable

It is not always best to have just one trustee. If the kids get along, two or three trustees may be preferable if they bring different skills to the administrative process. Splitting up the work can be helpful, as administrating an estate can be very time-consuming — especially if a trustee is a full-time employee or lives far from the family house that requires work prior to its sale.

A possible complication is that siblings often get along while the parents are alive and doing all their own work, but that may not continue. Even if the kids agree on everything else, one of them may dislike the family CPA, lawyer, insurance agent, real estate agent, or financial planner, or prefer to use their own, while the other wants to continue using the family's advisors. It's amazing what two people can disagree about!

When there are co-trustees, there can often be resentment that they are performing the services for free and they are working different amounts of hours. When there is a sole trustee who is paid a "reasonable fee" according to the trust, the other siblings may be very upset that the trustee is paid thousands of dollars to perform what should be a free service to the family. Like decisions to leave money to the grandchildren and split the rest among the children, these decisions are hard to make and may cause friction, but that is the point. No matter what is done, there may be hostility. The proper choice is the one that minimizes disharmony while keeping the original intent of the trust.

Should a sole trustee be selected — and if so, which child to select — are tough decisions. Hopefully, the person who drafts the trust or will understands this family dynamic and spends some time explaining the choices to the client. If a sole trustee is chosen, all that's left is to pick one of the kids and explain that to the others. Maybe it is better not to tell the kids and let them know only after death.

About the author

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1 *Deneny v. Van Rossem* 946 N.Y.S. 2d (2011)

2 In California a trustee can be removed where hostility or lack of cooperation among co-trustees impairs the administration of the trust. CA Probate Code §15642(b)(3)

3 CA Probate Code §15620

4 CA Probate Code §16013

5 CA Probate Code §15622

6 CA Probate Code §17200(b)(6)

7 CA Probate Code §15620

8 See Texas and Washington for example, Tex. Prop. Code §113.085 and RCW 11.98.016

News Briefs

Commuting costs not deductible — A taxpayer was not allowed to deduct commuting costs even though his daily round-trip drive was more than 150 miles.[1] The taxpayer could not prove that the job was indefinite, i.e., that it would last for less than 12 months.

1 *Cor v. Comm.*, TCM 2013-240

Related party rules prevent recognition of loss on sale to grantor trusts — A capital loss on the sale of partnership property to grantor trusts was disallowed under IRC §267 and/or IRC §707(b)(1)(A).[2]

The Chief Counsel had to review a complex set of entity structures, including several grantor trusts, to determine how the constructive ownership rules applied to the various parties. The ruling concluded that grantor trusts should be treated as disregarded entities for all federal tax purposes, including the related-party rules.

2 CCA 201343021

IRS addresses receipt of National Mortgage Settlement payments — The IRS has released guidance addressing the treatment of payments received by homeowners under the National Mortgage Settlement program due to the foreclosure of the taxpayer's principal residence.[3]

Certain borrowers who lost their homes in foreclosure during the years 2008–2011 are entitled to payments in the amount of approximately $1,400.