

March 1st, 2013
Mr. Steven T. Miller
Acting Commissioner
Internal Revenue Service
CC:PA:LPD:PR (REG-130507-11)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Proposed rule REG-130507-11

Dear Acting Commissioner Miller:

The National Funeral Directors Association (the "NFDA") is pleased to have the opportunity to submit these comments on REG-130507-11, proposed regulations regarding Net Investment Income Tax, and its application to electing section 685 qualified funeral trusts ("QFTs").

REG-130507-11 provides guidance under section 1411 of the Internal Revenue Code (the "Code"), which imposes a tax on the "net investment income" of certain individuals, trusts and estates. This notice of proposed rulemaking ("NPRM") elaborates on the statute by providing additional information on the types of persons subject to, as well as the amounts of tax imposed under, section 1411.

The NPRM states that although section 1411 applies to QFTs, "[t]he Treasury Department and the IRS request comments as to whether there may be administrative reasons to exclude [such] trusts from section 1411." The NFDA and its members believe that there are strong and compelling reasons to exclude QFTs from section 1411 and urge you to revise the regulations accordingly. The NFDA and its members also believe that, to the extent section 1411 does apply to QFTs, clarification is needed to determine how the section 1411 tax should apply to QFTs that are single state law trusts holding and investing funds on behalf of multiple funeral services and merchandise beneficiaries.

Background

NFDA is the world's leading funeral service association, serving 19,000 individual members who represent more than 10,200 funeral homes in the United States and internationally.

In general, a QFT is a trust that arises as a result of a person entering into a pre-need funeral arrangement with a funeral or burial service provider for funeral services or merchandise. The QFT holds and invests the trust funds and uses the funds solely to make payments for the agreed-upon funeral services or merchandise.

QFTs serve two important purposes:

- First, QFTs enable individuals to pre-fund their funeral expenses in order to relieve the burden of making such arrangements on their family members.
- Second, QFTs simplify the burden of tax compliance on such individuals by enabling the funeral director/trustee of the QFT to elect to report and pay the tax on income the QFT generates rather than the trust beneficiary.

QFTs typically consist of a single state law trust that administers funds on behalf of multiple preneed funeral service beneficiaries. As a common example, many state Funeral Director Associations and other entities often establish a so-called "master trust" as a single trust to hold and invest the QFT funds on behalf of a multitude (even thousands) of beneficiaries. While the income generated in the QFT attributable to each beneficiary may be relatively minimal, a single state law funeral trust may generate substantial aggregate levels of income. In addition, individual funeral homes may also have a number of these trusts which they administer as well.

But for section 685, pre-need funeral trusts would be taxed as grantor trusts, which could require the funeral director/trustee to send hundreds of 1099 forms to the IRS and individual trust beneficiaries. Trust beneficiaries would then be obliged to file with the IRS and pay tax on whatever small amount of income their pre-need funeral trust generated during the year.

Congress enacted section 685 as a tax simplification and paperwork reduction measure.¹ The administrative convenience of QFTs is especially significant for individuals who may have difficulty filing the complex tax returns that could be necessary if pre-need funeral arrangements were taxed as grantor trusts. Individuals who may be elderly or infirm are therefore among the primary beneficiaries of section 685.

QFTs Should Be Exempt From Section 1411

Section 1411(a)(2) imposes a tax for each taxable year equal to 3.8 percent of the lesser of (A) the trust's undistributed net investment income, or (B) the excess (if any) of (i) the trust's adjusted gross income (as defined in section 67(e)) for such taxable year, over (ii) the dollar amount at which the highest tax bracket in section 1(e) begins for such taxable year.

Proposed Treas. Reg. § 1.1411-3(b) provides a list of trusts that are exempt from the section 1411 tax, but the list does not include QFTs. The preamble to the proposed regulations confirms that the proposed regulation rules do not currently exclude QFTs from the section 1411 tax.

¹ See S. Rep. No. 105-33, at 286 (1997) (explaining the purpose of section 685 is to simplify reporting and administrative rules in lieu of the otherwise applicable grantor trust rules for pre-need funeral trusts).

As a general policy matter, the NFDA believes that QFTs should be exempt from the section 1411 tax because subjecting QFTs to this tax is inconsistent with the purpose of section 685. Just as section 685 exempts QFTs from the burdensome tax compliance requirements of the grantor trust rules, so too should Proposed Treas. Reg. § 1.1411-3(b) be revised to exempt QFTs from the burdensome tax compliance requirements of section 1411.

Clarification of Application of Section 1411 to QFTs

Notwithstanding the NFDA's belief that QFTs should be exempt from section 1411 on general policy grounds, to the extent QFTs are to be subject to the section 1411 tax, NFDA believes that further clarification is necessary for how such tax should apply to QFTs, in particular, due to their unique nature. QFTs typically consist of a single state law trust, such as a master trust, that administers funds on behalf of multiple pre-need funeral service beneficiaries. While the adjusted gross income attributable to each beneficiary in such a trust may not exceed the applicable threshold to be subject to section 1411, the trust itself may have sufficient aggregate adjusted gross income to trigger the tax. As a result, section 1411 may tax pre-need funeral trusts in a manner not intended by Congress.

Such a clarification would be consistent with section 685(c), which provides that section 1(e) (marginal income tax rates applicable to trusts) shall be applied to each QFT by treating each beneficiary's interest in each such trust as a separate trust. Such a clarification would also be consistent with the remainder of the proposed regulations under section 1411, which generally apply the income tax rules of chapter 1 of the Code.

Conclusion

The NPRM recognizes the unique nature of QFTs, describing them as trusts that "may have special computational rules." We hope that you will agree that the Treasury Regulations under section 1411 should be revised to exempt QFTs from section 1411 in order to preserve the important tax simplification measure of section 685 for all Americans, especially those who are elderly or infirm. We also hope that, to the extent the section 1411 tax does apply to QFTs, you will ensure that the regulations do not impose section 1411 tax inaccurately on QFTs held in a master trust or other aggregate arrangement.

Thank you for considering our comments on REG-130507-11 as it applies to QFTs. If you would like to discuss our comments in more depth or have any questions, please feel free to contact me at (202) 547-0441, or jfitch@nfda.org.

On locatory,

John H. Fitch, Jr.

Senior Vice President, Advocacy

National Funeral Directors Association