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SUMMARY:

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Professor Joel Newman examines the politics behind the tax provisions dealing with preneed funeral trusts.

Joel S. Newman is a professor of law at Wake Forest University. For years, he has been searching for something, anything, that might liven up his course on the income taxation of trusts.

Newman traces the legislative history of *section 685*, which creates the qualified funeral trust. He argues that, while the provision might be beneficial to the large funeral home conglomerates, it could be downright harmful to the low-income purchasers of preneed funeral trusts, whose complaints led to its enactment. On balance, he concludes, it is a bad provision.

1 Estate planning is one thing; funeral planning is quite another. Some of us make a comfortable living doing estate planning. We, and sometimes even our clients, come to appreciate the exercise of financial power, the gamesmanship. However, as to funerals, unless one is bound and determined to be the life /1/ of every party (even that one), there is little pleasure in the planning. Perhaps people can be persuaded to do it, but only if they can be assured that they will never, ever, have to think about it again.

2 That's where preneed funeral trusts come in. You get to choose your funeral arrangements while you're still alive. You set up a trust fund to pay for them, and often, you lock in the price. Your children won't have to make the choices, and they won't have to pay for them. What's more, they can't screw it up. Best of all, you will never, ever have to think about it again. /2/

3 There is another reason why preneed funeral trusts are popular with consumers. They shelter assets and income for Medicaid eligibility purposes. /3/ Of course, this feature of preneed funeral trusts is relevant only for low-income consumers. However, it has been estimated that from 50 to 70 percent of all preneeds are Medicaid driven. /4/

4 Preneeds are popular with the funeral industry as well. What seller wouldn't want to lock in a sale years in advance? There are, however, two quite different segments of the funeral industry. There are the small independents, and there are the large, corporate conglomerates. For the independents, preneeds are largely an accommodation to their customers. /5/ However, for the large conglomerates, preneeds are a separate line of business.

5 The conglomerates grow by acquisition. As they get bigger, many of the services they provide become cheaper, due to economies of scale. Therefore, if they can presell at current prices funeral services to be performed some years hence, they can make a profit, assuming that the cost to them of providing those services will be going down, not up. /6/

6 For all of these reasons, preneed funeral trusts are a growing phenomenon, both here and abroad. /7/ In New [*712] Jersey alone, there are some \$ 150 million dollars in preneed trust assets, representing some 40,000 separate accounts. /8/ In Texas, at the end of 1997, there were \$ 734 million in preneed trust assets. /9/ By 1996, it was estimated that there were already five million preneed funeral contracts outstanding. /10/ It is predicted that, by the turn of the century, half of the funerals in the United States will be pre-paid. /11/

7 It can be tempting for funeral homes to be in control of so much of other people's money. Now and then, there is fraud. /12/ Accordingly, the funeral business is regulated by the Federal Trade Commission, /13/ and pre-need trusts in particular are heavily regulated by the states. /14/

8 There are, of course, tax considerations as well. Most of these trusts are revocable. Those trusts should be grantor trusts pursuant to *section 676*. /15/ Accordingly, income from trust assets would be taxable to the purchaser, as owner. /16/

9 Even when they are irrevocable (which makes things simpler for Medicaid purposes), the trust assets are still earmarked to defray an obligation of the grantor. Therefore, they should also be grantor trusts under *section 673*, because the use of the trust funds for funeral expenses is considered a reversion to the grantor. /17/ They may also fall under *section 677(a)*, since the income may be applied in discharge of a legal obligation of the grantor or the grantor's spouse. /18/

10 For the preneed funeral trusts that are Medicaid driven, taxation at the grantor level is a good thing. If the income is taxed to the purchasers as grantors, there is usually no tax liability, for their income, even with the trust income added on, would still be below taxable thresholds. In contrast, such trusts, if taxed as nongrantor trusts, would actually have to pay some tax.

11 The funeral homes, however, often prefer nongrantor trust treatment. First, the record keeping is far simpler at the trust level. Second, there are marketing concerns. In the preneed area, the competition is between trust funding and insurance funding. With insurance funding, there is no tax, and no tax reporting, at the purchaser level. Once the purchasers buy the insurance, they never, ever, hear about it again. With trust funding, it depends. If the trusts are treated as grantor trusts, then there will be periodic tax reports to the grantors, whether or not any tax is actually due. However, if the trusts are treated as nongrantor trusts, then there are no tax reports to the grantors. Treatment of the preneed trusts as nongrantor trusts would 'effectively drive a stake in the heart' of the best argument the funeral insurance people have -- that only by using insurance funding can the purchasers avoid those annoying tax forms. /19/

12 The recordkeeping and marketing concerns apply to all funeral homes. However there is another reason for preferring nongrantor trust treatment that applies only to the large conglomerates. The small independents have neither the time nor the resources to worry about how the trust funds are invested. The conglomerates have both.

13 If preneed trusts are treated as grantor trusts, then the purchaser/grantors will demand that the trust assets be invested almost entirely in tax-exempt bonds, since they won't want to pay any tax. Tax-exempt investment means low returns. Conversely, if the income is taxed at the trust level, then trust funds can be managed more aggressively. As long as the trust is paying the tax, the grantors won't care. In that event, investment of trust assets could be diversified, with the greater returns far outstripping the tax bill. /20/

14 Whether grantor trust treatment was a good thing or a bad thing [***713**] for preneeds, it was the right thing. However, despite a 1973 revenue ruling, /21/ funeral homes were treating preneeds in wildly inconsistent ways for tax purposes. In the late 1980s, the IRS considered promulgating a broader ruling. The IRS wanted to make it crystal clear that, no matter what form the preneed took, it would still be a grantor trust. /22/

15 In the face of impending government action, the industry responded. /23/ In 1986, a coalition was formed by the National Funeral Directors Association, representing more of the independents, the International Cemetery and Funeral Association, representing more of the conglomerates, /24/ and two large conglomerates, Service Corporation International /25/ and Stewart Enterprises. The coalition fought on two fronts -- IRS and Congress. On the IRS front, they tried to talk the IRS out of the ruling, and failed.

16 *Rev. Rul. 87-127* came out in November 1987. /26/ While Revenue Ruling 73-140 had set forth only one factual situation, 87-127 had four. The differences involved the purchasers' options on cancellation. In the first situation, on cancellation, the purchaser received the principal and all accumulated income. In the second, income was paid as earned to the seller, so that, on cancellation, the purchaser received only the principal. In the third, the purchaser's only right on cancellation was to choose a new funeral home to perform the agreed services. In the fourth, income was accumulated in the trust, and, on cancellation, paid to the seller, while the principal was returned to the purchaser. The Service held that all four were grantor trusts, as to all principal and income. /27/

17 Having failed to prevent *Revenue Ruling 87-127*, the coalition tried to persuade Congress to override it. The coalition itself drafted legislative proposals, but none of them got anywhere. /28/ Ultimately, the Senate Finance Committee drafted a provision on preneed funeral trusts. Pursuant to this provision, trusts with assets no greater than \$ 5,000

would be subject to a flat 15 percent tax payable at the trust level, with a \$ 1,000 annual exemption per funeral home. Each funeral home would file one return; there would be no returns filed by the grantors. /29/ Congress never acted on this proposal. /30/

18 Next, the coalition talked to the Chairman of the House Ways and Means Committee, Dan Rostenkowski, D-III. He was sympathetic to their concerns, and told them that, if the funeral industry were unanimously behind them, he would sponsor legislation. They assured him that the industry spoke with one voice. /31/

19 They were wrong. The October 1988 meeting of the National Funeral Directors Association in New Orleans included a Preneed Tax Workshop. The presidents of the Texas and Ohio Funeral Directors Associations spoke against *Revenue Ruling 87-127*, and in favor of new legislation. However, the Director of the New Jersey Funeral Directors Association spoke in favor of the ruling. He was not alone. A number of states were on either side, with the independents tending to oppose new legislation and the conglomerates, especially Service Corporation International, tending to favor it. /32/

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20 Some of the states that opposed new legislation made certain that Chairman Rostenkowski got the message. Clearly, the funeral industry was not of one voice. Rostenkowski refused to sponsor any legislation.

21 After the New Orleans meeting, the National Funeral Directors Association decided that this was a lose/lose issue for them. Any position that they took would anger some of their constituents. Therefore, they decided not to take any further, active positions. /33/

22 After 1988, things quieted down on the legislative front, but they became quite messy on the compliance front. No one could agree on how to report income from these trusts. Some filed blank Forms 1041 with attachments and K-1s, and others filed Forms 1099. /34/ Some consolidated returns; others did not.

23 Eventually, the IRS sorted out the proper reporting technique. In 1991, in a Technical Advice Memorandum, the IRS ruled that the proper reporting form was a 1041. /35/ Later, in 1995, a regulation was promulgated that made things more flexible, allowing either 1099s or 1041s, with alternatives depending on whether the grantor trusts were single or multiple. /36/

24 Whatever method of reporting was used, the compliance was at first burdensome, especially for the banks who had taken over the lion's share of the business in their respective states. However, as time went on, the banks got better at it. At the same time, computer technology was improving. With experience, technology, and IRS cooperation, compliance became easier.

25 Perhaps things were getting better for the trustees, but they were not getting any less confusing for the trust purchasers. Remember, these purchasers most assuredly did not want to hear about these things again. Nonetheless, they were getting tax forms, and grantor advice letters. They did not understand them, so they called. Some of these customers were just lonely, and welcomed any excuse to call anyone. Others were angry.

26 Service Corporation International had many preneed customers, so, every year between January and April, it got many calls. It was devoting a significant number of hours to fielding telephone calls from confused customers. So, SCI acted. It started inserting more detailed explanations in its grantor letters. The explanations ended with a suggestion. If the purchasers were displeased, SCI advised them to complain to Congress. Many did just that. /37/

27 Apparently, a number of members of the House forwarded the complaints to the Ways and Means staff. Staff members reacted by drafting a provision to 'fix' the problem. /38/ At the last minute, the provision was stuck into the House version of the Balanced Budget Act of 1995.

28 The bill drafted by Ways and Means staff would have allowed trustees of qualified preneed funeral trusts to have the trusts treated as nongrantor trusts. Contributions could not exceed \$ 5,000 for the benefit of any individual. The personal exemption was eliminated. In effect, with income from assets of \$ 5,000 or less and no personal exemption, Qualified Funeral Trusts would be taxed at a flat 15 percent. /39/

29 Rep. Patsy Mink, D-Hawaii, also heard from her constituents. She proposed a bill in 1995 as well. /40/ Pursuant to her bill, the provider of the funeral services, and not the grantor, would be treated as the owner of preneed funeral trusts. /41/ Her bill was mandatory, while the staff bill was elective.

30 The Mink bill was not enthusiastically received by the funeral home industry. According to the industry, the bill had at least two problems, both of which stemmed from its mandatory nature. First, it would have meant that many Medicaid-driven trusts would be taxable for the first time. Second, in a number of states, it would have been a violation of state law to [*715] make tax payments out of trust funds. Therefore, presumably the funeral homes would have to pay them. /42/ The ICFA attempted to talk to Rep. Mink's staff, but they were unable to make contact. /43/

31 The National Funeral Directors Association had nothing to do with either of these proposals. In fact, when the two bills came to the NFDA's attention, it asked Ways and Means staffers where they had come from. Ways and Means staffers told them about the 'drawerful' of complaints forwarded to them by members of Congress. /44/

32 The staff bill passed both houses of Congress in 1995, though in slightly different forms. The House bill had a contribution cap of \$ 5,000; /45/ the Senate bill a cap of \$ 7,000. /46/ ICFA sent a broadcast fax to all of its members in the districts of the House- Senate conferees, asking them to push for the \$ 7,000 cap, and they succeeded. /47/ However, the resulting Balanced Budget bill was vetoed by President Clinton. Afterward, the Ways and Means Committee announced that it intended to revisit the tax issues that hadn't made it. /48/

33 The preneed trust issue was revisited in 1997. Two bills were submitted. The one that got somewhere came from Rep. Wally Herger, R-Calif. Rep. Herger believed that the tax laws should be simplified, and that the way to do it was one provision at a time. /49/ He asked an outgoing aide to give him a list of tax provisions that had been proposed, but not enacted. One of them was the funeral trust provision. /50/ Rep. Herger resubmitted the 1995 staff proposal as a free-standing bill in 1997. /51/

34 Rep. Mink also submitted a bill, /52/ stating that *Revenue Ruling 87-127* had created a 'bureaucratic inequity.' /53/ The Mink bill was identical to the Herger bill, except that the Mink bill would have been mandatory, not elective.

35 A Ways and Means Committee staff member asked the International Cemetery and Funeral Association to explain why they preferred the Herger bill to the Mink bill. The ICFA did just that. /54/ It was, of course, an easy sell, since the Herger bill was the Ways and Means draft, while the Mink bill was not. The Herger bill went forward.

36 Not much lobbying was necessary at this point. Of course, it did not hurt at all that both Service Corporation International, and Bill Archer, Chairman of the House Ways and Means Committee, were from Houston. /55/ The major effort of the NFDA was to get the Herger bill to be considered by the Senate Finance Committee. In this effort, they dealt mainly with Finance Committee staff. They successfully got an identical bill introduced. /56/ Since there were no differences between the House /57/ and Senate bills, /58/ there was no need for a conference. The bill was enacted as part of the Taxpayer Relief Act of 1997, creating new *section 685*. /59/

37 Since the enactment of section 685, there has been some activity. On the administration side, the government has drafted Form 1041-QFT, to be used when making Qualified Funeral Trust elections. /60/ There have been some industry comments on the form. /61/ On the legislative side, there is language in the Internal Revenue Restructuring and Reform Act of 1998, which would allow a qualified funeral trust to continue to qualify for special treatment for the 60-day period after the decedent's death, even though that death might [*716] otherwise have terminated grantor trust status. /62/ Finally, there have been a few pieces explaining the provision. /63/

38 The postenactment activity described above is proof that there are groups who plan to use the new elective procedure of *section 685*. These groups are most likely the large conglomerates. Most of the individual preneed trust purchasers would be well advised not to make the election. /64/

39 Herein lies the great irony. A number of people have characterized the enactment of *section 685* as a shining example of democracy at work, as an effort that was truly driven by the concerns of individual taxpayers, not those of the lobbyists. Indeed, it was. And yet, the people who complained about receiving the 1099s and grantor letters, the 'blue hairs,' as one industry representative put it, /65/ are the very ones who really didn't need section 685, and, in some cases, might actually be harmed by making the election. /66/ As one funeral industry person put it, by the time this legislative process reached its end game, the people involved had lost track of how the whole thing started. At that point, they just wanted a win. /67/

40 Is *section 685* a worthy addition? Probably not. /68/ At least it's elective, so it can be avoided.

41 Does it simplify the code? Probably not. The taxation of funeral trusts used to be a straightforward application of the grantor trust rules. Now there's an exception. Exceptions rarely simplify.

42 Trust purchasers used to have no choice about tax treatment. Now, they have a choice. Choice is good, provided the choosers understand their options. However, adding choices rarely simplifies. Apparently, the conglomerates will find life to be simpler. But they weren't the ones who were complaining.

43 Due to baby boomers such as myself, the funeral industry is a growth industry. There is competition, and pressure to generate sales. In their zeal to sell preneeds, the salespeople emphasize what sells best -- that the purchaser will never, ever, have to think about them again. Too bad more of them didn't mention that there would be some tax forms in the mail -- annoying, perhaps, but nothing that would really force thought. Had they mentioned that, there might not have been a story to tell.

44 Then again, the 'blue hairs' asked for a fix, and they got it. Indeed, they urned it.

FOOTNOTES

/1/ Life?

/2/ See Kelly Shermach, 'Pay Now, Die Later: Consumers Urged Not to Delay That Final Decision,' *Marketing News*, Oct. 24, 1994, at 1; Bob Richards, 'Funeral Pre-Planning Insurance Carries Pitfalls,' *Capital Times* (Madison, Wisc.), March 15, 1997, at 1C. Note that, while various forms of burial insurance have been around for a long time, preneed trusts are a relatively recent phenomenon.

/3/ 42 USCA section 1382, 45 CFR Section 233.20. See Medicare and Medicaid Guide (CCH) paragraph 14,311.

/4/ Telephone interview with Sue Simon, Editor, *Preneed Perspective* (June 24, 1998); Telephone interview with Wilson Beebe, Director, NJ Funeral Directors Association NJFDA (June 22, 1998).

/5/ Indeed, in *TAM 9541004*, *95 TNT 201-13*, it was alleged that the preneed trust in question would generate a net economic loss.

/6/ Telephone interview with Sue Simon, Editor, *Preneed Perspective* (June 24, 1998). For a further description of the conglomeration of funeral homes, see Darryl J. Roberts, *Profits of Death* 139-140 (1997). In 1997, 15 percent of all funeral homes in the United States were owned by conglomerations.

One large manufacturer of caskets formed a subsidiary to sell and administer preneed funeral trusts and insurance, presumably due to lagging casket sales and the growing popularity of cremation. 'Hillenbrand Subsidiary Quietly Enters Trust Business; State Associations Share Mixed Reactions,' *Death Care Business Advisor*, v. 1, no. 17 (March 20, 1997).

/7/ Rosanna Spero, 'People Cope With Costly Funerals by Paying for Them in Advance,' *Daily Mail London*, U.K. May 22, 1996; 'Funeral Planning by Trust,' *The Press Christchurch*, New Zealand July 8, 1996.

/8/ Telephone interview with Wilson Beebe, Director, NJFDA (June 22, 1998).

/9/ Telephone interview with Sue Simon, Editor, *Preneed Perspective* (June 24, 1998).

/10/ Robert W. Habenstein and William M. Lamers, *The History of American Funeral Directing* 378 (Howard C. Raether, ed., 4th rev. ed., 1996).

/11/ Darryl J. Roberts, *Profits of Death* 156 (1997).

/12/ *Lebron v. Mechem Financial, Inc.*, 27 F.3d 937 (3d Cir. 1994); 'Funeral Director Waives Arraignment in Thefts,' *Manchester Union Leader*, April 22, 1997, at A4; Mary Rae Bragg, 'Plot Owners to Get Credits on Merchandise,' *Telegraph Herald*, Dubuque, Iowa March 26, 1997, at a1; 'Embezzler Gets 90 Days,' *Chicago Tribune*, June 5, 1997, at N3; Mary Jo Layton, 'Agencies Monitor Compliance With Funeral Home Regulations,' *Bergen Record* (New Jersey), April 27, 1997, at A16.

/13/ Trade Regulation Rule Concerning Funeral Industry Practices, 16 C.F.R. Part 453.

/14/ For citations to the various state laws, see Judith A. Frank, 'Preneed Funeral Plans: The Case for Uniformity,' 4 *Elder Law J. 1*, notes 8 and 9 (1996) hereinafter 'Frank'; and Michael Denham, 'Comment: Taxpayers Get a Sigh of Relief: Congress Corrects Mistaken Interpretation of Grantor Trust Rules by the IRS in the Taxpayer Relief Act of 1997,' 29 *Tex. Tech. L. Rev. 181*, notes 29 and 204 (1998) hereinafter 'Denham'.

/15/ Section references are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder, except as otherwise noted.

/16/ *Rev. Rul. 87-127, 1987-2 C.B. 157, 87 TNT 223-5.*

/17/ *Section 673, Rev. Rul. 87-127, 1987-2 C.B. 157.* Given the age of most purchasers, the value of the reversionary interest usually exceeds 5 percent of the value of trust assets.

/18/ *Section 677(a), Treas. reg. section 1.667(a)-1(d); Rev. Rul. 87-127, 1987-2 C.B. 157.*

/19/ 'Pending Legislation May Eliminate 1099s,' 4 *Preneed Perspective* 7, July, 1997, at 1.

/20/ Telephone interview with Sue Simon, Editor, *Preneed Perspective* (June 24, 1998). This factor is irrelevant in those states in which, for a variety of reasons, the conglomerates have no say as to how the trust funds are invested.

/21/ *Rev. Rul. 73-140, 1973-1 C.B. 323.* The effect of an earlier case, *Angelus Funeral Home v. Commissioner*, 407 F.2d 210 (9th Cir. 1969), is unclear. That case held that the funeral home was taxable on preneed payments in the year of receipt. See Denham, *supra* note 14.

/22/ Telephone interview with Wilson Beebe, Director, NJFDA (June 22, 1998). Telephone interview with Scott Gilligan, counsel to National Funeral Directors Association NFDA (June 22, 1998).

/23/ Glen G. McMillen Fulbright & Jaworski, 'Income Taxation of Preneed Funeral Trusts: *Revenue Ruling 87-127* and Other Developments' (February 1988) prepared for the members of the NFDA; copy on file with the author; hereinafter McMillen.

/24/ Telephone interview with Sue Simon, Editor, *Preneed Perspective*, June 24, 1998. Independent/conglomerate is not the only division among funeral industry associations. The North Carolina Funeral Directors Association is largely white, while the Funeral Directors & Morticians Association of North Carolina, Inc. is largely African-American. Neither group was active in the lobbying efforts. Telephone interview with Larry Stegall, NC Funeral Directors Association (June 19, 1998); Fax from J.B. Cutchins, Jr., past President, Funeral Directors & Morticians Assoc. of NC (June 22, 1998).

/25/ Check out SCI's web site at <http://www.sci-corp.com>. I was especially intrigued with the 'SCI Escape School' mentioned on their home page. Escape from what, to what?

/26/ *Rev. Rul. 87-127, 1987-2 C.B. 157.*

/27/ *Id.* See 'Taxation of Preneed Funeral Trusts. *Rev. Rul. 87-127, 1987-48 IRB 21,*' *Banking Law J.* May-June 1988, at 275; Jacques T. Schlenger, Robert F. Madden, William G. Murray, 'Current Tax Developments,' *Estate Planning*, May-June 1988, at 174; LTRS 8923018 and 9801027.

In Denham, *supra* note 14, *Revenue Ruling 87-127* is criticized because the author believes that it should be the funeral home, not the purchaser, which is considered the owner. This position was taken in Rep. Mink's first bill, *infra* note 40. Also, this position was taken in LTR 8929040, 89 *TNT 152-58*, which was later withdrawn by LTR 8935023, 89 *TNT 182-71*. I am unconvinced by Denham's argument.

However, I agree with Denham that the ruling would have been more complete had it spelled out more clearly why the entire trust income should be taxable to the grantor in each of the four situations.

/28/ McMillen, *supra* note 23, at 12.

/29/ H.R. 3545, 100th Cong., *section 6841*, approved by the Senate Finance Committee on October 16, 1987.

/30/ McMillen, *supra* note 23, at 12.

/31/ Telephone interview with Robert Fells, counsel, International Cemetery and Funeral Association ICFA (June 16, 1998).

/32/ Telephone interview with Wilson Beebe, Director, NJFDA (June 22, 1998).

/33/ *Id.*

/34/ The problem with the 1099 method, although it was simpler, was that there was no place on the form to subtract expenses like trustees' fees.

/35/ TAM 9140006, 91 TNT 207-14.

/36/ Treas. reg. section 1.671-4, 60 Fed. Reg. No. 245 (Dec. 21, 1995).

/37/ Telephone interview with John Fitch, NFDA (June 15, 1998); Telephone interview with Tom Simms, Service Corporation International (June 19, 1998); 'Pending Legislation May Eliminate 1099s,' 4 Preneed Perspective No. 7, July, 1997, at 1; 'For Better or for Worse, the Playing Field Is Flatter,' 4 Preneed Perspective No. 8, August, 1997, at 1. In one state, the bank that had cornered the market on administering funeral trusts mollified customers by offering to pay any taxes due. Presumably, the actual payments were out of trust funds. Such payments would have been illegal in many states, though not in that one.

/38/ Telephone interview with Robert Fells, counsel, ICFA (June 16, 1998). 'Pending Legislation May Eliminate 1099s,' 4 Preneed Perspective No. 7, 1 (July, 1997); 'For Better or for Worse, the Playing Field Is Flatter,' 4 Preneed Perspective No. 8, 1 (August, 1997).

/39/ Ways and Means Budget Reconciliation Recommendations as Forwarded to the House Budget Committee and Released on September 25, 1995, at page 358 of CCH version, CCH Special 4, vol. 82, N. 44, Oct. 3, 1995.

/40/ 1995 H.R. 1729, 104 H.R. 1729 104th Cong. (1995). Telephone interview with Melissa Unemori Hampe, former legislative assistant to Rep. Mink (June 10, 1998); letter from Rep. Patsy Mink to author (July 29, 1996) (on file with author).

/41/ Id. at new *section 672(G)(1)*. It really shouldn't have mattered whether the trust or the funeral home was taxable, except for a possible difference in bracket. Either way, the taxes would reduce the payments ultimately made to the funeral homes for the preneed services. Therefore, ultimately, it was coming out of their pocket.

/42/ See supra note 14 for cites to state statutes.

/43/ Telephone interview with Robert Fells, counsel, ICFA (June 16, 1998).

/44/ Telephone interview with Scott Gilligan, counsel, NFDA (June 22, 1998).

/45/ H.R. 2491, 104th Cong., *Section 14607* (1995).

/46/ H.R. 2491, 104th Cong., *Section 11606* (amended) (1995).

/47/ H.R. Conf. Rep. No. 104-347, at H12509 (1995); Telephone interview with Robert Fells, counsel, ICFA (June 16, 1998). The caps were inserted to placate the Treasury Department, which feared tax sheltering. Telephone interview with John Fitch, NFDA (June 15, 1998). Compare the \$ 7,000 cap to the average cost of funerals in 1997 of about \$ 5,500. Denham, supra note 14, at 181.

/48/ 'U.S. Budget: Tax Proposals From Balanced Budget Bill to Be Revisited by Ways and Means This Year,' DTR, March 15, 1996.

/49/ I am not at liberty to disclose the source of this information. However, both my source and I consider it to be a compliment to Rep. Herger.

/50/ Telephone interview with Wilson Beebe, Director, NJFDA (June 22, 1998).

/51/ H.R. 479, 105th Cong. (1997).

/52/ H.R. 684, 105th Cong. (1997).

/53/ 143 Cong. Rec. E2245-01 (Extension of Remarks of Rep. Patsy Mink, Feb. 12, 1997).

/54/ Telephone interview with Robert Fells, counsel, ICFA (June 16, 1998).

/55/ It should be noted, however, that the original impetus for the 1995 Ways and Means draft was the constituent complaints, forwarded by members of Congress to the staff. When the 1995 bill was drafted, it had not even occurred to Ways and Means staff that Service Corporation International was headquartered in Rep. Archer's home district.

/56/ Telephone interview with John Fitch, NFDA (June 15, 1998).

/57/ H.R. 2014, Taxpayer Relief Act of 1997; Report No. 105-148, Revenue Reconciliation Act of 1997, Report of the Committee on the Budget, House of Representatives, to Accompany H.R. 2014, 105th Cong. (1997).

/58/ S. 949, Report No. 105-33, Senate Finance Committee, 105th Cong. (1997).

/59/ Taxpayer Relief Act of 1997, Pub. L. No. 105-34, *section 1309*.

/60/ Notice 98-6, 1998-3 *IRB* 52.

/61/ 'Firm Recommends Electronic Filing of Funeral Trust Forms,' 97 *TNT* 233-35; 'Trust Bank Comments on Qualified Funeral Trust Rules,' 97 *TNT* 233-36; 'NFDA Offers Suggestions on Funeral Trusts,' Tax Notes, Nov. 10, 1997, p. 672.

/62/ Senate Finance Committee Report 105-174 on H.R. 2676, April 24, 1998, at 200, explaining *section 6013* of H.R. 2676. This provision was suggested to congressional staff by the funeral industry. Since the provision is in the nature of a technical correction, no member of Congress need be involved. This provision was *section 6013* of the act amending code *section 685*.

/63/ Denham, *supra* note 14; Bernard Barnett, 'Fiduciary Income Tax Planning After the Taxpayer Relief Act,' 136 *Trusts and Estates* No. 11, October, 1997, at 56.

/64/ If they could only get past the annoyance of the tax reporting forms, most low-income preneed trust purchasers would see no tax payable on their trusts as grantor trusts, and some tax payable on their trusts as nongrantor trusts. I am informed, for example, that there will be very few elections made in North Carolina. For further proof that the election will not be a boon to funeral trust purchasers, the provision is a tax revenue raiser. The 1995 provision was projected to generate something under \$ 8 million for the period fiscal 1996 through fiscal 2002. Louis Alan Talley, 'Taxation of Earnings on Pre-Need Funeral Trusts,' CRS Report for Congress 96-265 March 21, 1996, at CRS-5.

/65/ You'll just have to believe me that someone said this to me. There's no way that I will divulge this name.

/66/ For those trusts that lock in a stated package of goods and services, there is no harm to the consumer whatsoever from making the election. Even if taxes are paid on trust income, the funeral home will still provide the same funeral.

However, for those trusts that merely state that whatever funds are available at death will be used to provide whatever funeral can be purchased, there is harm in making the election, if that depletes the trust by tax payments. Even if the money doesn't quite come out of the purchaser's hide, it is chiseled out of his coffin. I am informed that most Medicaid-driven preneed trusts are of the latter variety, and that in fact there are usually not sufficient funds in trust at death to provide for the average funeral. Telephone interview with Terry Hayworth, Hayworth-Miller Funeral Homes, Winston-Salem, NC (June 30, 1998).

Then again, if the large conglomerates can really generate a better return on trust investments, then perhaps the tax wouldn't matter.

/67/ Telephone conversation with Wilson Beebe, NJFDA (June 22, 1998).

/68/ Thinking more generally about prepayments, I wonder why prepaid college tuition gets a better deal under *section 529*. There is no income until the tuition is used, and then it is taxable at the student's likely low bracket. Shouldn't prepaid tuition plans be taxable as grantor trusts, either because they are revocable (*section 676*), or because they will be used to discharge a legal obligation of the grantor (*section 677*)? See *Morrill v. United States*, 228 *F.Supp.* 734 (D. Me. 1964); *Wyche v. United States*, 31 *AFTR2d* 75-5816 (Ct.Cl. 1974). See generally Sheryl Stratton, 'Prepaid Tuition Programs Major in Political Science,' Tax Notes, July 8, 1996, p. 153; J. Timothy Philipps, 'Federal Taxation of Prepaid College Tuition Plans' 47 *Wash. & Lee L. Rev.* 291 (1990).

I suppose it makes sense to treat the states, which provide prepaid college tuition plans, better than we do the commercial funeral establishments. However, why should we encourage college education over death? I mean, which one is more avoidable?

END OF FOOTNOTES

INDEX: trusts, funeral

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