University of Richmond Law Review

Volume 43 | Issue 4 Article 4

5-1-2019

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MAX'S TAXES: A TAX-BASED ANALYSIS OF PET TRUSTS *

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"The greatness of a nation and its moral progress can be judged by the way its animals are treated."

Mahatma Gandhi [1]

I. INTRODUCTION

Humans and charities are no longer the primary entities many individuals wish to benefit upon death. Instead, there is a growing interest in providing for Rover, Fluffy, and Polly—our beloved pets. There has been a recent surge of public interest in pet planning as high-profile individuals have died with significant provisions in their wills or trusts for the benefit of their animals. For example, when Leona Helmsley died in 2007, she left $12 million in her will to a trust to benefit her white Maltese dog named Trouble.[2] Several years earlier, when singer Dusty Springfield

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* Currently, "Max" is one of the top names for pets in America based on the veterinarian responses to a survey conducted by the American Society for the Prevention of Cruelty to Animals (ASPCA). Holly Hartman, *The Most Popular Pet Names*, http://www.infoplease.com/spot/petnamespot.html (last visited Apr. 6, 2009).

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1. Animals Quotes, http://thinkexist.com/quotations/animals/ (last visited Apr. 6, 2009).

2. *People: World's Richest Dog*, TIME, Sept. 10, 2007, at 21. While leaving $12 million to Trouble, Ms. Helmsley left only $5 million to two grandchildren and nothing to her other two grandchildren. Alan Feuer, *Helmsley, Through Will, Is Still Calling the Shots*, N.Y. TIMES, Aug. 30, 2007, at B2.

died, reports surfaced that her will contained provisions in favor of her cat, Nicholas—such as for his bed to be lined with Dusty's nightgowns, Dusty's recordings to be played when Nicholas retired to bed each evening, and that Nicholas be fed imported baby food.[3] Carlotta Liebenstein's passage of her $80 million estate to her dog, Gunther, also made headlines.[4] Even earlier, when Doris Duke, the sole heir to Baron Buck Duke who built Duke University and started the American Tobacco Company, died, she left $100,000 in trust for the benefit of her pet poodle, Minnie.[5]

This increase in the special estate planning needs of pet owners is reflected by legal scholarship,[6] continuing legal education programs,[7] and legislative action[8] in the pet trust arena. But little time has been devoted to the tax ramifications of pet trusts, although brief discussions are included in several articles.[9] The purpose of this article is to fill this gap and give practitioners guidance as to how pet trusts are treated for tax purposes and to suggest to Congress how the Internal Revenue Code ("I.R.C.") should be amended to clarify taxation issues. Part II provides basic background information on pet trusts before addressing the tax issues. Parts III–V examine the income, estate, and gift tax consequences for a pet trust on the federal and state levels. To

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3. Larry Sulton et al., *Dusty's Cool Fat Cat*, PEOPLE, Apr. 19, 1999, at 11.

4. Feuer, *supra* note 2.

5. *In re* Estate of Duke, No. 4440/93, slip. op. at 1 (N.Y. Surr. Ct. July 31, 2007) (upholding trust and quoting relevant provisions of Duke's will), *available at* http://www.thesmokinggun.com/archive/dukedog1.html; Bill Zwecker, *Moore and More for Vanity Fair*, CHI. SUN-TIMES, Nov. 10, 1993, at 30.

6. *See, e.g.*, Susan R. Abert, *Pet Trusts: The Uniform Trust Code Gives Enforceability a New Bite*, N.H. B.J., Winter 2006, at 18; Gerry W. Beyer, *Pet Animals: What Happens When Their Humans Die?*, 40 SANTA CLARA L. REV. 617, 664–65 (2000); Elizabeth Paek, *Fido Seeks Full Membership in the Family: Dismantling the Property Classification of Companion Animals by Statute*, 25 U. HAW. L. REV. 481, 514 (2003); Breahn Vokolek, *America Gets What it Wants: Pet Trusts and a Future for its Companion Animals*, 76 UMKC L. REV. 1109, 1109 (2008).

7. *See generally* Megan J. Ballard, Gonzaga University School of Law CLE: Doing Well by Doing Good in Animal Defense Law Cases (Sept. 26, 2008) (examining estate planning with companion animals); Gerry W. Beyer, Estate Planning for Animal Lovers (2008) (presentation at the 18th Annual Festival of Legal Learning, University of North Carolina School of Law) (providing guidance on how to protect pet animals after the owner's disability or death).

8. *See* Barry A. Densa, *Setting up Fido for Life—Pet Trust Accounts*, http://www.bankrate.com/brm/news/advice/20020916a.asp (last visited Apr. 6, 2009) (noting the increase in legislative action with section 2-907 of the Uniform Probate Code added in 1993, section 408 of the Uniform Trust Code in 2000, and the repeal of the rules against perpetuities in many states).

9. *See, e.g.*, Abert, *supra* note 6, at 20–21.

assist in this process, "AJ" and "Pat," two hypothetical clients, will be used to provide a basis for the existing and proposed rules: AJ is the wealthy pet owner of Max, a dog, and Charlie, a horse; Pat is an average wage-earner pet owner of Socks, a cat. Parts III–V apply these implications to AJ's and Pat's pet trust needs.

II. BACKGROUND OF PET TRUSTS

A. *History*

Providing for pet animals has a long and interesting history.[10] For example, in the 1889 English case of *In re Dean,* the chancery court upheld a testamentary gift for the maintenance of the testator's horses and hound dogs.[11] The first reported case in the United States dealing with a gift for the benefit of a specific animal was not decided until 1923, in *Willett v. Willett*, where Kentucky's highest court determined that the testator's desire to care for her pet dog was a humane purpose and thus valid.[12]

This auspicious beginning, however, was not generally followed by subsequent United States cases.[13] Attempted gifts in favor of specific animals usually failed for a variety of reasons, such as violation of the rule against perpetuities because the measuring life was not human,[14] or for being an unenforceable honorary trust because it lacked a human or legal entity as a beneficiary who would have standing to enforce the trust.[15]

B. *The Traditional Pet Trust*

To counter these problems, astute estate planners fashioned the technique that has come to be known as the *traditional pet*

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10. *See* Beyer, *supra* note 6, at 621–25; Jennifer R. Taylor, *A 'Pet' Project for State Legislatures: The Movement Toward Enforceable Pet Trusts in the Twenty-First Century*, 13 QUINNIPIAC PROB. L.J. 419, 420–24 (1999).

11. *In re* Dean, 41 Ch.D. 552, 563 (1889).

12. Willett v. Willett, 247 S.W. 739, 741 (Ky. 1923).

13. *See, e.g.*, *In re* Estate of Russell, 444 P.2d 353, 355–56, 362–63 (Cal. 1968).

14. *See, e.g.*, Note, *Validity of Trusts in Favor of Animals*, 42 YALE L.J. 1290, 1290–93 (1933).

15. *See, e.g.*, RESTATEMENT (SECOND) OF TRUSTS §112 (1957) ("A trust is not created unless there is a beneficiary who is definitely ascertained at the time of the creation of the trust or definitely ascertainable within the period of the rule against perpetuities."); *see also* CAL. PROB. CODE §15205(a) (West 1991) (providing that "[a] trust, other than a charitable trust, is created only if there is a beneficiary"); *Russell*, 444 P.2d at 363.

trust in which the pet owner creates a trust in favor of a human beneficiary (the pet's caregiver) and then requires the trustee to make distributions to the beneficiary to cover the pet's expenses, provided the beneficiary is taking proper care of the pet.[16] This technique avoids the two traditional problems with gifts to benefit pet animals because the actual beneficiary is a human for both measuring life and standing purposes.

Even though the traditional pet trust provided a mechanism for a pet owner to provide for his or her pets, this technique required the pet owner to locate not only a competent attorney specializing in estate planning, but also one with pet trust experience. Many courts were less than receptive to gifts that benefited animals unless the trusts were carefully crafted.[17] This limited the ability of many clients, especially those with modest estates, to provide for their beloved companions.

What the law needed was a way of validating a simple gift such as "I leave $1,000 for the care of my dog, Spike" and providing default terms so that the gift could take effect as most likely intended by the pet owner. In other words, the law needed a pet equivalent of the Uniform Gifts/Transfers to Minors Act custodianships, which had already gained widespread acceptance.[18]

C. *The Statutory Pet Trust*

A seed was needed to start a change in the law, and the planting of that seed occurred in 1990 when the National Conference of Commissioners on Uniform State Laws added section 2-907 to the Uniform Probate Code ("UPC"), validating a trust with a duration of twenty-one years or less which provides for the care of a designated domestic or pet animal and the animal's offspring.[19] Three years later, the Commissioners amended section 2-907, making

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16. *See, e.g.*, Darin I. Zenov & Barbara Ruiz-Gozalez, *Trusts for Pets*, FLA. B.J., Dec. 2005, at 22, 22, 24, 26.

17. *See, e.g.*, Beyer, *supra* note 6, at 629–35.

18. *See* UNIF. GIFTS TO MINORS ACT (superseded 1984), 8A U.L.A. 297, 299 (2003) [hereinafter UGMA]; UNIF. TRANSFERS TO MINORS ACT, 8C U.L.A. 1 (2001) [hereinafter UTMA]; *see also* Thomas E. Simmons, *Using Trusts to Settle Lawsuits*, PROB. & PROP., Nov.–Dec. 2005, at 52, 53 (noting adoption of the UTMA by all but two states, Vermont and South Carolina, who retain a version of the UGMA).

19. UNIF. PROBATE CODE § 2-907 (amended 1993); Christine Cave, Comment, *Trusts: Monkeying Around with Our Pets' Futures: Why Oklahoma Should Adopt a Pet-Trust Statute*, 55 OKLA. L. REV. 627, 644–45 (2002).

two significant changes.[20] First, the twenty-one year duration was eliminated to permit a pet trust to be used for long-lived animals such as horses and parrots,[21] and second, the pet owner could no longer provide for "grandchildren pets," that is, the animal's offspring.[22]

State legislatures were reluctant to adopt the UPC pet provision, with less than half of the UPC states adopting the pet trust section.[23] As a result, this new *statutory pet trust* technique was available in sixteen states—the enacting states plus those with free-standing statutes based on the UPC.[24]

The seed received significant watering and fertilizing when authorization for statutory pet trusts was included in section 408 of the Uniform Trust Code ("UTC"), which the National Conference of Commissioners on Uniform States Laws adopted in 2000.[25] Unlike the UPC, the UTC gained widespread acceptance with enactment in twenty states, the District of Columbia, and introduction in 2008 in Connecticut, Massachusetts, and Oklahoma, often without the legislature giving independent consideration to the "hidden" authorization of statutory pet trusts.[26]

20. *See* UNIF. PROBATE CODE § 2-907 (amended 1993); Cave, *supra* note 19, at 645.

21. Cave, *supra* note 19, at 645.

22. *Id.*

23. *See* ALASKA STAT. § 13.12.907 (2008); ARIZ. REV. STAT. ANN. § 14-2907 (2005); COLO. REV. STAT. § 15-11-901 (2006); FLA. STAT. ANN. § 736.0408 (West Supp. 2009); IOWA CODE ANN. § 633A.2105 (West Supp. 2008); MICH. COMP. LAWS ANN. § 700.2722 (West 2002); MO. ANN. STAT. § 456.4-408 (West 2007); MONT. CODE ANN. § 72-2-1017 (2007); NEV. REV. STAT. ANN. § 163.0075 (LexisNexis 2003); N.J. STAT. ANN. § 3B:11-38 (West 2007); N.M. STAT. § 45-2-907 (2008); N.Y. EST. POWERS & TRUSTS LAW § 7-8.1 (Consol. 2007); N.C. GEN. STAT. § 36C-4-408 (2007); OR. REV. STAT. § 130.185 (2007); UTAH CODE ANN. § 75-2-1001 (Supp. 2008); WASH. REV. CODE ANN. §§ 11.118.005 to .110 (West 2006).

24. *See supra* note 23.

25. *See* UNIF. TRUST CODE § 408 (amended 2005), 7C U.L.A. 490 (2006).

26. *See* Unif. Law Comm'rs, A Few Facts About the . . . Uniform Trust Code, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-utc2000.asp (last visited Apr. 6, 2009) (listing the following states: Alabama, Arizona, Arkansas, District of Columbia, Florida, Kansas, Maine, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Virginia, and Wyoming); *see also* ALA. CODE § 19-3B-408 (LexisNexis 2007); ARK. CODE ANN. § 28-73-408 (Supp. 2007); D.C. CODE § 19-1304.08 (Supp. 2008); FLA. STAT. ANN. § 736.0408 (West Supp. 2009); KAN. STAT. ANN. § 58a-408 (2005); ME. REV. STAT. ANN. tit. 18-B, § 408 (Supp. 2008); MO. ANN. STAT. § 456.4-408 (West 2007); NEB. REV. STAT. § 30-3834 (2008); N.H. REV. STAT. ANN. § 564-B:4-408 (LexisNexis 2006); N.M. STAT. § 45-2-907 (2008); N.D. CENT. CODE § 59-12-08 – 8 (Supp. 2007); OHIO REV. CODE ANN. § 5804.08 (LexisNexis 2006); OR. REV. STAT. § 130.185 (2007); 20 PA. CONS. STAT. ANN. § 7738 (West Supp. 2008); S.C. CODE ANN. § 62-7-408 (2007); TENN. CODE ANN. § 35-15-408 (2007); VA. CODE ANN. § 55-544.08 (Supp. 2008); WYO. STAT. ANN. § 4-10-409 (2007).

At the insistence of various animal welfare organizations and because of the positive publicity that legislators and governors receive from enacting and approving such provisions, nine other states authorized statutory pet trusts, either by following the UPC or UTC models or by designing their own statutes.[27] Approximately forty states and the District of Columbia now have legislation authorizing statutory pet trusts.[28]

D. *The Honorary Pet Trust*

One state has enacted a statute dealing with pet trusts but did not provide for their enforcement.[29] In Wisconsin, the trustee may carry out a non-traditional pet trust but is not required to do so.[30] Use of honorary pet trusts is not recommended because of the availability of traditional or statutory pet trust statutes in many jurisdictions.[31] Ambiguity can be removed by specifying the set-

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27. *See* FLA. STAT. ANN. § 736.0408 (West 2009); IDAHO CODE ANN. § 15-7-601 (Supp. 2008); IND. CODE ANN. § 30-4-2-18 (LexisNexis Supp. 2008); IOWA CODE ANN. § 633A.2105 (West Supp. 2008); NEV. REV. STAT. ANN. § 163.0075 (LexisNexis 2003); N.J. STAT. ANN. § 3B:11-38 (West 2007); N.Y. EST. POWERS & TRUSTS LAW § 7-8.1 (Consol. 2007); R.I. GEN. LAWS § 4-23-1 (Supp. 2008); TEX. PROP. CODE ANN. § 112.037 (Vernon 2007); WASH. REV. CODE ANN. §§ 11.118.005 to .110 (West 2006).

28. *See* ALA. CODE § 19-3B-408 (LexisNexis 2007); ALASKA STAT. § 13.12.907 (2008); ARIZ. REV. STAT. ANN. § 14-2907 (2005); ARK. CODE ANN. § 28-73-408 (Supp. 2007); CAL. PROB. CODE § 15212 (West Supp. 2009); COLO. REV. STAT. § 15-11-901 (2006); D.C. CODE § 19-1304.08 (Supp. 2008); FLA. STAT. ANN. § 736.0408 (West Supp. 2009); HAW. REV. STAT. § 560:7-501 (2006); IDAHO CODE ANN. § 15-7-601 (Supp. 2008); 760 ILL. COMP. STAT. ANN. 5/15-2 (West 2007); IND. CODE ANN. § 30-4-2-18 (LexisNexis Supp. 2008); IOWA CODE ANN. § 633A.2105 (West Supp. 2008); KAN. STAT. ANN. § 58a-408 (2005); ME. REV. STAT. ANN. tit. 18-B, § 408 (Supp. 2008); MICH. COMP. LAWS ANN. § 700.2722 (West 2002); MO. ANN. STAT. § 456.4-408 (West 2007); MONT. CODE ANN. § 72-2-1017 (2007); NEB. REV. STAT. § 30-3834 (2008); NEV. REV. STAT. ANN. § 163.0075 (LexisNexis 2003); N.H. REV. STAT. ANN. § 564-B:4-408 (LexisNexis 2006); N.J. STAT. ANN. § 3B:11-38 (West 2007); N.M. STAT. § 45-2-907 (2008); N.Y. EST. POWERS & TRUSTS LAW § 7-8.1 (Consol. 2007); N.C. GEN. STAT. § 36C-4-408 (2007); N.D. CENT. CODE § 59-12-08 (Supp. 2007); OHIO REV. CODE ANN. § 5804.08 (LexisNexis 2006); OR. REV. STAT. § 130.185 (2007); 20 PA. CONS. STAT. ANN. § 7738 (West Supp. 2008); R.I. GEN. LAWS § 4-23-1 (Supp. 2008); S.C. CODE ANN. § 62-7-408 (2007); S.D. CODIFIED LAWS § 55-1-21 (Supp. 2008); TENN. CODE ANN. § 35-15-408 (2007); TEX. PROP. CODE ANN. § 112.037 (Vernon 2007); UTAH CODE ANN. § 75-2-1001 (Supp. 2008); VA. CODE ANN. § 55-544.08 (West Supp. 2008); WASH. REV. CODE ANN. §§ 11.118.005 to .110 (West 2006); WIS. STAT. ANN. § 701.11 (West 2001); WYO. STAT. ANN. § 4-10-409 (2007).

29. *See* Cave, *supra* note 19, at 651–52 (listing California, Missouri, Tennessee, and Wisconsin). California and Missouri now follow section 408 of the UTC, and Tennessee now provides for enforcement as well. *See, e.g.*, TENN. CODE ANN. § 35-15-408 (2007). Only Wisconsin continues to recognize honorary pet trusts but fails to provide for their enforcement. *See* WIS. STAT. ANN. § 701.11 (West 2001).

30. *See* WIS. STAT. ANN. § 701.11 (West 2001).

31. *See infra* Part II.E.

tlor's wishes in a traditional or statutory pet trust, and trustees are not bound to follow the settlor's wishes in an honorary pet trust.[32]

E. *Which Type of Pet Trust Is Better?*

Many pet owners will prefer the traditional pet trust because it gives the pet owner the ability to control the pet's care rather than having a statute or a court determine what the pet needs. For example, the owner may specify who manages the property (the trustee), the pet's caregiver (the beneficiary), what type of expenses relating to the pet the trustee will pay, the type of care the animal will receive, what happens if the beneficiary can no longer care for the animal, and the disposition of the pet after the pet dies.

If the owner, however, has a modest estate or is not interested in supplying what he or she may view as endless details, a statutory pet trust provides a quick, economical, and easy method to carry out the pet owner's intent. Of course, this assumes that the pet owner establishes the trust in one of the jurisdictions that has enacted statutory pet trust legislation.

III. INCOME TAXATION OF PET TRUSTS

Pet trusts face income tax implications—at the federal and possibly state levels.[33] The income of a trust is potentially taxed to one or more of the following entities: (1) the settlor—typically the pet owner—if the trust is inter vivos; (2) the beneficiary—typically the pet's caregiver; or (3) the trust as a taxable entity itself.[34]

A. *Federal Income Tax*

After the settlor places property into a pet trust, the trustee has the duty to make the property productive, which normally

32. *See supra* Part II.B–C.

33. *See* I.R.C. § 641 (2006); *infra* Part III.B.

34. See I.R.C. §§ 1, 61(a)(15), 641; I.R.S., INSTRUCTIONS FOR FORM 1041 AND SCHEDULES A, B, D, G, I, J, AND K-1 2 (2008) [hereinafter 1041 INSTRUCTIONS], *available at* http://www.irs.gov/pub/irs-pdf/i1041.pdf (noting that the beneficiary pays the income tax on the distribution).

means to earn income or to appreciate in value—capital gains—or both.[35] When that income is received or accrues, one must determine the entity responsible for the federal income tax on that income. Until 1976, the answer to the question of whether to tax pet trust distributions was simple: they were not taxed.[36] The case of *In re Searight's Estate* illustrated this point: to be taxed, the beneficiary receiving property must be a person.[37] Because a statutory pet trust's beneficiary is a pet, and a pet is not a person, the money given to the pet could not be taxed.[38] Because this income was not taxed, the "loophole" allowed individuals to give money to establish pet trusts without income tax consequences—a problem the Internal Revenue Service ("IRS") fixed in 1976.[39]

Under Revenue Ruling 76-486, the IRS does not recognize a pet as a "person"; therefore, a pet cannot be taxed under the I.R.C.[40] To prevent pet owners from leaving money to pets for tax avoidance purposes, the ruling voided any traditional trust which named a pet as a beneficiary.[41] Without a state statute allowing pet trusts, the ruling invalidates the attempted pet trust because beneficiaries are persons, a pet is not a "person," and, therefore, a pet could not be a beneficiary.[42] A side effect of this ruling was to change the traditional method of deducting distributions from the trust's income.

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35. *See* RESTATEMENT (THIRD) OF TRUSTS § 90 (2007).

36. *See* Abert, *supra* note 6, at 20.

37. 95 N.E.2d 779, 784 (Ohio Ct. App. 1950).

38. *See id.*

39. Rev. Rul. 76-486, 1976-2 C.B. 192, 192–93.

40. *Id.*; *see In re Searight's*, 95 N.E.2d at 784 (holding that the $1,000 the decedent bequeathed to his dog could not be subjected to taxes because the property passes to an animal, not a person, and only persons, institutions, or corporations can be taxed). *See also* Abert, *supra* note 6, at 20.

41. *See* Rev. Rul. 76-486, 1976-2 C.B. 192, 193. A traditional trust must have a human beneficiary person and a pet is not a person, so a pet cannot be a beneficiary; without a beneficiary, no trust exists. *See* RESTATEMENT (THIRD) OF TRUSTS § 43 (2003) ("A person who would have capacity to take and hold legal title to the intended trust property has capacity to be a beneficiary of a trust of that property; ordinarily, a person who lacks capacity to hold legal title to property may not be a trust beneficiary."). Courts cannot enforce a trust without trust language providing for an ascertainable beneficiary. *See id.* § 44 ("A trust is not created, or if created will not continue, unless the terms of the trust provide a beneficiary who is ascertainable at the time or who may later become ascertainable within the period and terms of the rule against perpetuities.").

42. Rev. Rul. 76-486, 1976-2 C.B. 192, 193. The effect of invalidating the trust is to pass to residuary legatee.

The ruling also explained that states, through specific legislation, can allow a pet to be a trust beneficiary.[43] Revenue Ruling 76-486 stated that statutory pet trusts were to be taxed under "section 1(d) of the Code pursuant to section 641," thus taxing pet trusts in the same manner as other trusts.[44] In 1976, the tax rate contained in I.R.C. § 1(d) included tax rates for married individuals filing separately as well as estates and trusts.[45] Subsequently, in 1977, § 1(d) was changed by creating a "trust and estate tax rate" under I.R.C. § 1(e).[46] This change left only the tax rate for married individuals filing separately under § 1(d), which contained new, more favorable tax rates and brackets.[47] Section 1(e) now reads as follows:

> "There is hereby imposed on the taxable income of—
> (1) every estate, and
> (2) every trust,
> taxable under this subsection a tax determined in accordance with the following table:

If taxable income is:	**The tax is:**
Not over 1,500	15% of taxable income.
Over $1,500 but not over $3,500	$225, plus 28% of the excess over $1,500.
Over $3,500 but not over $5,500	$785, plus 31% of the excess over $3,500.
Over $5,500 but not over $7,500	$1,405, plus 36% of the excess over $5,500.
Over 7,500	$2,125, plus 39.6% of the excess over $7,500[48]

43. *Id.*

44. *Id*; *see also* I.R.C. § 641(a) (1976) (current version at I.R.C. § 641(a) (2006)).

45. I.R.C. § 1(d) (1976) (current version at I.R.C. § 1(d) (2006)). Specifically, the statute read: "There is hereby imposed on the taxable income of every married individual . . . who does not make a single return jointly with his spouse under section 6013, *and of every estate and trust taxable under this subsection*, a tax determined in accordance with the following table[.]" *Id.* (emphasis added).

46. Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126, 130–31; *see* I.R.C. § 1(e) (2006).

47. I.R.C. § 1(d) (2006) ("There is hereby imposed on the taxable income of every married individual . . . who does not make a single return jointly with his spouse under section 6013, a tax determined in accordance with the following table.").

48. *Id.* § 1(e).

Therefore, Revenue Ruling 76-486 likely called for pet trusts to be taxed under § 1(d) simply because, in 1976, that section pertained to estates and trusts. Based on the 1977 amendment, however, statutory pet trusts are now most likely taxed at the rate established by § 1(e), which pertains solely to estates and trusts. This is also consistent with the fact that, in 1976, Revenue Ruling 76-486 taxed statutory pet trusts in the same manner as non-pet trusts.[49]

1. Taxable to Settlor[50]

Taxes on an inter vivos pet trust might be owed by the settlor. The federal income tax is based on an individual's adjusted gross income derived from all sources generating a gain for the taxpayer.[51] If an individual acquires the pet trust by means of a "gift, bequest, devise, or inheritance," then that property is exempted from income taxes.[52] When the trust is created, the transfer to the trust is not counted as income for the trustee, beneficiary, or caregiver; rather, the grantor or settlor would pay any tax liability—gift tax if inter vivos or estate tax if testate.[53]

Income that the trust property earns thereafter is subject to federal income tax unless an exclusion or deduction applies.[54] The trustee files a Form 1041 "U.S. Income Tax Return for Trusts and Estates" if the trust's gross income is greater than $600.[55] Income is realized only when the funds within the trust earn interest or dividends, whether this income is accumulated or distributed.[56] Because income tax is triggered by the income earned off the corpus of the trust, it does not matter whether the trustee distri-

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49. *See* Rev. Rul. 76-486, 1976-2 C.B. 192, 193.

50. Only if the trust is inter vivos could this situation occur. Otherwise, the estate would be responsible for estate taxes and not the deceased settlor.

51. I.R.C. § 61(a).

52. *Id.* § 102 ("Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance . . . [s]ubsection (a) shall not exclude from gross income . . . (2) where the gift, bequest, devise, or inheritance is of income from property, the amount of such income.").

53. *See id.* §§ 2002, 2502(c), 2511(a), (c).

54. *Id.* § 641(a).

55. *See* 1041 INSTRUCTIONS, *supra* note 34, at 4.

56. *See* I.R.C. § 641(a) ("The tax imposed by section 1(e) shall apply to the taxable income of estates or of any kind of property held in trust, including income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.").

butes the money.[57] Thus, the federal income taxation of revocable inter vivos pet trusts should operate under traditional trust income taxation laws, which are beyond the scope of this article.[58]

2. Taxable to Beneficiary

If a statutory or traditional pet trust is created that names a human beneficiary, then the beneficiary would pay income taxes on the trust income.[59] The individual beneficiary and the pet's caregiver are usually the same person.[60] For example, the beneficiary could be the pet owner's child who will also take care of the pet. But the beneficiary and the caregiver do not have to be the same person.[61] If the caregiver is not the beneficiary, the animal's caregiver serves merely as an agent for the trust, and the only taxable income for the caregiver is on amounts paid for services under normal tax rules. Like any other income, then, the beneficiary pays income tax on trust distributions received.[62] On the other hand, if the caregiver of the pet is also the beneficiary, then the caregiver reports income from the trust as personal income.[63] Whether the trust itself is taxed on the distributions made depends on the classification of the trust.[64] If distributions are made in either of these first two situations—settlor or beneficiary—those individuals pay the federal income tax on this income if required, and the trust takes a deduction.[65] If income is earned but not distributed, then the trust pays taxes at the trust rates, and the trust also pays the tax when a non-human (i.e., pet) is the beneficiary, as would be the case in a statutory pet trust.[66]

57. *See id.*

58. See generally 42 AM. JUR. 2D *Inheritance, Estate, and Gift Taxes* §§ 71-93 (2000), for a discussion of the tax treatment of inter vivos trusts.

59. I.R.C. § 61(a)(15).

60. *See* Beyer, *supra* note 6, at 666.

61. *Id.* at 664–68.

62. *Id.* If the caregiver is reimbursed for the pet's expenses or is paid a fee for his or her time, the caregiver would most likely be subject to income tax on this income. *Id.*; *see* discussion *infra* Part III.A.4.

63. I.R.C. § 61(a)(15).

64. *See id.* § 661. Trusts are allowed to deduct the distributable net income paid to the caregiver/beneficiary or settlor as these individuals are people. *Id.*

65. *Id.*

66. *See infra* Part III.A.3.

3. Taxable to Trust

The amount taxed to a pet trust and the tax rate for each of the three types of pet trusts might be different. The tax rate for a traditional pet trust on earned income is taxed at the normal trust rate under I.R.C. § 1(e).[67] Likewise, a statutory trust is probably taxed at the trust rate of § 1(e) even though Revenue Ruling 76-486 states that a statutory trust is taxed at the rate under § 1(d).[68] Both of these pet trusts would have a beneficiary appointed by the settlor-pet owner or by the court in states adopting the UTC.[69] In states where a pet trust becomes an honorary trust, the statutory-tax-rate status would not apply—even though this is a type of statutory pet trust—because the honorary pet trust is invalid for I.R.C. purposes (despite the court treating the trust as valid if the trustee is willing to carry out the trust's purpose).[70] Most likely, all three trust types will be taxed under § 1(e), rendering this commentary moot. An honorary trust is taxed at the same rate as a traditional trust under § 1(e) but operates without a beneficiary for income tax deduction purposes.[71] So the income tax on an honorary pet trust or statutory pet trust (with a pet beneficiary) could be significantly higher than the income tax on a traditional pet trust depending on the distributions and deductions made throughout a tax year.

Trusts are normally permitted to deduct distributions to beneficiaries from their income to arrive at their taxable income.[72] The effect of Revenue Ruling 76-486 also changed the simple pet distribution procedure; now, pet trust distributions may or may not be taxed depending on whether the beneficiary is a human or a pet, and this resulting change could affect the income taxes of both the pet trust and the beneficiary.[73] Because pets are not

67. I.R.C. §§ 1(e), 641(a).

68. Rev. Rul. 76-486, 1976-2 C.B. 192, 192–93; *see* I.R.C. § 1(e); Rev. Proc. 2007-66, 2007-45 I.R.B. 970, 970–72 (providing the inflation adjustments and rate bracket adjustments for I.R.C. § 1); discussion *supra* Part III.A.

69. *See* UNIF. TRUST CODE § 408(b) (amended 2005), 7C U.L.A. 490 (2006).

70. *See* Rev. Rul. 76-486, 1976-2 C.B. 192, 192–93.

71. *Id.*; *see* I.R.C. §§ 1(e), 641(a).

72. I.R.C. § 651(a).

73. Rev. Rul. 76-486, 1976-2 C.B. 192, 193. Trusts are permitted to deduct distributions to beneficiaries from their income to arrive at taxable income. I.R.C. § 651; *see* 1041 INSTRUCTIONS, *supra* note 34, at 2.

people, however, a statutory pet trust is liable for tax on the income a trust earns, but is not credited for distributions made to the pet beneficiary.[74] Thus, a statutory pet trust's income is not reduced by distributions made on behalf of the pet, and all income, whether distributed or not, must be taxed at the trust rate under I.R.C. § 1(e).[75] The IRS's reasoning is logical since animals do not have a Social Security number, which would allow them to file tax returns and have their own tax rates.[76] But the ruling adds another tax implication for the practitioner trying to decide between a statutory pet trust and a traditional pet trust. Traditional trusts with a human beneficiary still enjoy distributions as deductible expenses to the trust's income.[77] A traditional trust benefits from the distributions made to the beneficiary because each distribution decreases the pet trust's tax liability.[78] What federal income tax advantages and disadvantages now exist for the thoughtful pet owner?

4. Tax Advantages for AJ and Pat

The following table summarizes the basic rules discussed above.

74. *See* Rev. Rul. 76-486, 1976-2 C.B. 192, 193.

75. *Id.* ("Furthermore, since the amounts of income required to be distributed under section 651 of the Code and amounts properly paid, credited, or required to be distributed under section 661 are limited to distributions intended for beneficiaries, a deduction under those sections is not available for distributions for the benefit of a pet animal. Similarly, such distributions are not taxed to anyone under sections 652 and 662."); *see* I.R.C. §§ 643(c), 652, 7701(a); Abert, *supra* note 6, at 20.

76. Abert, *supra* note 6, at 20, 23 n.24 ("Although some authorities are now recommending that pets have their owners' Social Security numbers tattooed on their thighs, this author has not discovered any proposal that animals should have their own tax identification numbers." (citation omitted).

77. *See* 1041 INSTRUCTIONS, *supra* note 34, at 2.

78. I.R.C. § 651(a). Trusts are permitted to deduct distributions to beneficiaries from their income to arrive at taxable income. *Id.*

Table 1: Summary of the Rules

Type of Trust	Tax Bracket	Distributions	Person / Entity Taxed
Traditional	I.R.C. § 1(e): Trust Rate	Deductible to trust Taxable as income to human beneficiary-caregiver or settlor	Income not distributed: trust Income distributed: settlor or human beneficiary
Statutory	I.R.C. § 1(e): Trust Rate	Not deductible to trust Not taxable as income to pet beneficiary[79]	Income: trust Income distributed: trust
Honorary	I.R.C. § 1(e): Trust Rate	Not deductible to trust Not taxable as income to non-human-beneficiary	Income: trust Income distributed: non-human beneficiary at trust rate

Because the trusts' tax rates and deductibility of distributions are different among the three pet trusts, the amount of federal income tax liability for traditional versus statutory and honorary pet trusts could vary. Similarly, the type of trust used will determine how much tax, if any, is owed by the beneficiaries (human or non-human). Application of federal income tax law to traditional and statutory trusts creates income tax advantages and disadvantages for beneficiaries and for the trust, which the AJ and Pat hypotheticals will demonstrate. Note that the potential taxes the settlor may owe are covered in Part IV.

a. Traditional Trust Scenarios

Scenario 1a—AJ's Traditional Trust with a Human Beneficiary

AJ wants to provide for Max and Charlie, so AJ creates a $1 million traditional pet trust in an account earning 5% annually

79. Some might argue that the distributions would be taxable as income but Revenue Ruling 76-486 states otherwise. Rev. Rul. 76-486, 1976-2 C.B. 192, 193.

and names Anne as the beneficiary and caregiver of Max and Charlie. In the first year after AJ's death, the trust earned $50,000 ($1 million principal multiplied by 5% interest).[80] Assume that pet expenses total $25,000 and Anne receives a $25,000 stipend.

Under Scenario 1a, the $50,000 distribution is deducted from the trust's income.[81] Thus, the income of the trust is zero in year one, and the trust's income tax is zero.[82] The distributions to Anne count towards her income so the trustee files a Form 1041 Schedule K-1.[83] Assume that Anne is unmarried and her income for tax bracket purposes is $78,850 before the distribution. The following chart shows her income tax:[84]

Tax Bracket: Anne	**Amount of Tax to Anne**
25%	$16,056 tax on $78,850 income
28%	$14,000 tax on trust distribution

Thus, under the traditional trust, the federal income tax owed is as follows:

1) Income tax liability of beneficiary Anne on trust distribution: $14,000
2) Income tax liability of pet trust: $0

The tax advantage of having a person, and not a pet, as a beneficiary with a traditional trust is the possibility of the trust distributing all income to pay tax at an individual's presumably lower rate as compared to the trust owing taxes at the higher trust tax rate.[85] One disadvantage for Anne, as the beneficiary, is using more than half of her stipend (trust distribution) to cover the income tax on the distribution. Pet owners should factor how much

80. For simplicity, the calculations do not take into account all I.R.C. sections.

81. *See* I.R.C. § 661(a).

82. *See id.*

83. *See* 1041 INSTRUCTIONS, *supra* note 34, at 2.

84. *See* Rev. Proc. 2007-66, 2007-45 I.R.B. 970, 972; *see also* U.S. CENSUS BUREAU, U.S. DEP'T OF COMMERCE, NO. P60-233, INCOME, POVERTY, AND HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2006, at 4 (2007) (stating that the median American household income in 2006 was $48,201), *available at* http://www.census.gov/prod/2007pubs/p60-233.pdf.

85. *See* I.R.C. § 661.

the caregiver's actual salary needs to be for payment of services plus reimbursement of pet expenses, and adjust accordingly for income taxes on the distributed amount with enough remaining for pet expenses. If a pet trust reimburses for only pet expenses and the caregiver performs the services for no salary, these distributions are still taxable. Thus, the trustee should be instructed to distribute to pay these expenses plus an amount equal to the anticipated taxes caused by the expense reimbursement. Also, this scenario assumes the total amount earned is distributed. If, however, a different situation exists and only $10,000 is distributed, the remaining $40,000 will be taxed at the trust rates,[86] creating a tax bill of $13,019 for the trust, and leaving Anne with $2,800 in taxes on the distribution—for a total tax bill of $15,819. Thus, the lower the income bracket of the beneficiary and the more income that is distributed, the lower the total tax liability is for both the trust and the human beneficiary.

Scenario 1b—Pat's Traditional Trust with a Human Beneficiary

Pat wants to provide for Socks, so Pat creates a $10,000 traditional pet trust in an account earning 5% annually and names Ben as the beneficiary and caregiver of Socks. In the first year after Pat's death, the trust earned $500 ($10,000 principal multiplied by 5% interest). Assume that pet expenses total $300 and Ben receives a $200 stipend to cover taxes.

Under Scenario 1b, the $500 distribution is deducted from the trust's income.[87] The income of the trust is $0 in year one, and the trust's income tax is $0.[88] Assume that Ben is unmarried and his income for tax bracket purposes is $32,550 before the distribution. The following chart shows his income tax:[89]

Tax Bracket: Ben	Amount of Tax to Ben
15%	$4,483 tax on $32,550 income
25%	$125 tax on trust distribution

86. Rev. Proc. 2007-66, 2007-45 I.R.B. 970, 972.
87. I.R.C. § 661.
88. *See id.*
89. *See* Rev. Proc. 2007-66, 2007-45 I.R.B. 970, 972.

Thus, under the traditional trust, the federal income tax owed is as follows:

1) Income tax liability of beneficiary Ben on trust distribution: $125
2) Income tax liability of pet trust: $0

Both Scenarios 1a and 1b deal with traditional trusts, but they present different amounts. The comparison between traditional and statutory trusts for different socioeconomic pet owners is more easily distinguishable when all the scenarios are compared together.[90]

b. Statutory Trust Scenarios

Now the scenario changes to reflect a "valid" statutory pet trust. Some uncertainty in the tax treatment for these types of trust exists, and the IRS has not cleared it up. The first possible treatment is that income earned, whether or not distributed by the trust, is taxed at the special rate under § 1(d). Scenarios 2a and 2b show how this analysis would work.

The second and more likely option is that all income earned by the statutory trust is taxed at the § 1(e) rate. The distributions, which are technically sent to the caregiver because Max is unable to deposit funds, are not treated as income to the caregiver, who is merely acting as an agent. Instead, the distributions are treated as income to the pets, and pets do not pay income taxes.[91] A possible advantage for the statutory pet trust over a traditional pet trust is that the settlor does not need to consider the income tax rate bracket of the beneficiary as in a traditional trust because, regardless of whether the income is distributed or not, the income tax liability in a statutory pet trust remains the same. This might be a helpful consideration to the pet owner, because the incentive to distribute all income and avoid the higher trust tax rate would not exist, which could prolong the life of the trust's corpus. Scenarios 2c and 2d illustrate this outcome.

90. *See infra* notes 101–05 and accompanying text.

91. Katharine Coxwell, *Paws Laws or How Nigel and Miss Muffy Came To Be Rich*, 67 ALA. LAWYER 433, 440 (2006) ("In spite of all their luxuries, pampered lifestyles and the belief by owners that their companion animal posses intelligence beyond that of the lowly human brain, not even the IRS has figured out a way to force Nigel or Miss Muffy to pay income taxes.").

Scenario 2a—AJ's Statutory Trust with a Non-Human Beneficiary and a Human Caregiver

As a resident of state *A*, AJ writes, "I leave in trust upon my death $1 million to provide for Max and Charlie and designate Anne as the caregiver." In the first year after AJ's death, the trust earned $50,000 ($1 million principal multiplied by 5% interest). Assume that pet expenses total $25,000 and Anne receives a $25,000 stipend.

Because Max and Charlie are non-human beneficiaries, the $25,000 in distributions would not be deducted from the trust's income for year one.[92] So the income of the trust in year one in this Scenario is $50,000 multiplied by the rate specified in § 1(d).[93]

Tax Bracket: Statutory Pet Trust	Amount of Tax to Trust
15% of $32,550	$4,483
25% over $32,550 but not over $65,725	$17,450 x .25 = $4,363

Thus, under the statutory trust, the federal income tax owed is as follows:

1) Income tax liability of pet trust: $8,846
2) Income tax liability of beneficiaries Max and Charlie: $0

This $50,000 incurs a total income tax liability of $8,846. This scenario plays out more favorably than under the traditional pet trust analysis in Scenario 1a because this scenario uses a lower rate than the trust rate under the traditional trust—or Anne's rate because of Anne's other non-trust-distribution income.

Scenario 2b—Pat's Statutory Trust with a Non-Human Beneficiary and a Human Caregiver

As a resident of state *A*, Pat writes, "I bequest in trust upon my death $10,000 to Socks and assign Ben as the caregiver." In the

92. Rev. Rul. 76-486, 1976-2 C.B. 192, 193.

93. *Id.*; *see* Rev. Proc. 2007-66, 2007-45 I.R.B. 970, 972.

first year after Pat's death, the trust earned $500 ($10,000 principal multiplied by 5% interest). Assume that pet expenses total $300 and Ben receives a $200 stipend.

Because Socks is a non-human beneficiary, the $300 in distributions would not be deducted from the trust's income for year one.[94] So the income of the trust in year one in this scenario is $500.

Tax Bracket: Statutory Pet Trust	**Amount of Tax to Trust**
10% of $500	$50

Thus, under the statutory trust, the federal income tax owed is as follows:

1) Income tax liability of pet trust: $50
2) Income tax liability of beneficiary Socks: $0

This $500 incurs a total income tax liability of $50. Again, a tax advantage exists because of Ben's income, decreasing the total amount of tax from $125 in Scenario 1b to $95.

Scenario 2c—AJ's Statutory Trust with a Non-Human Beneficiary and a Human Caregiver

The facts remain the same as in Scenario 2a.[95]

Under this last possibility, the trust income of $50,000 would be taxed at the § 1(e) rate.[96] Anne's $25,000 distribution would not be taxed at her individual tax rate because "such distributions are not taxed to anyone under sections 652 and 662."[97]

94. Rev. Rul. 76-486, 1976-2 C.B. 192, 193.

95. As a resident of state A, AJ writes, "I leave in trust upon my death $1 million to provide for Max and Charlie and designate Anne as the caregiver." In the first year after AJ's death, the trust earned $50,000 ($1 million multiplied by 5% interest). Assume that pet expenses total $25,000 and Anne receives a $25,000 stipend.

96. Rev. Rul. 76-486, 1976-2 C.B. 192, 193; *see also* I.R.C. §§ 1(e), 641 (2006).

97. Rev. Rul. 76-486, 1976-2 C.B. 192, 193.

Tax Bracket: Statutory Pet Trust	Amount of Tax to Trust
First $10,700	$2,764
35% over $10,700	$39,300 x .35 = $13,755

Thus, under this scenario, the federal income tax owed is as follows:

1) Income tax liability of caregiver Anne's stipend: $0
2) Income tax liability of pet trust: $16,519
3) Income tax liability of beneficiaries Max and Charlie: $0

This $50,000 incurs a total income tax liability of $16,519.

Scenario 2d—Pat's Statutory Trust with a Non-Human Beneficiary and a Human Caregiver

The facts remain the same as in Scenario 2b.[98]

The trust income of $500 is taxed at the § 1(e) rate.[99] Ben's $200 distribution is not taxed at his individual tax rate because "such distributions are not taxed to anyone under sections 652 and 662."[100]

Tax Bracket: Statutory Pet Trust	Amount of Tax to Trust
15% of $500	$75

Thus, under this scenario, the federal income tax owed is as follows:

1) Income tax liability of caregiver Ben's stipend: $0
2) Income tax liability of pet trust: $75
3) Income tax liability of beneficiary Socks: $0

This $500 incurs a total income tax liability of $75.

98. As a resident of state *A*, Pat writes, "I bequest in trust upon my death $10,000 to Socks and assign Ben as the caregiver." In the first year after Pat's death, the trust earned $500 ($10,000 principal multiplied by 5% interest). Assume that pet expenses total $300 and Ben receives a $200 stipend.

99. Rev. Rul. 76-486, 1976-2 C.B. 192, 193; *see also* I.R.C. §§ 1(e), 641 (2006).

100. Rev. Rul. 76-486, 1976-2 C.B. 192.

Table 2: Summary of the Scenarios

Type of Trust	Total Tax Beneficiary, Caregiver, or Beneficiary-Caregiver Owes	Total Tax Trust Owes	Total Tax
AJ's Traditional (1a)	$14,000	$0	$14,000
AJ's Statutory (2a)	$0	$8,846	$8,846
AJ's Statutory (2c)	$0	$16,519	$16,519
Pat's Traditional (1b)	$125	$0	$125
Pat's Statutory (2b)	$0	$50	$50
Pat's Statutory (2d)	$0	$75	$75

The traditional pet trust for AJ, in which all earned income was distributed to human beneficiaries, had the best income tax advantage for AJ because of the human's lower tax bracket rate and ability of the trust to deduct its distributions compared to AJ's statutory pet trust using the rates of I.R.C. § 1(e). However, a change in the amount of distributions can nullify any tax advantage that the traditional pet trust would seem to enjoy over a statutory pet trust. When one also considers that a statutory pet trust may not have the higher creation costs that may be associated with the traditional trusts, pet planners will want to carefully consider the amount of distributions planned versus the amount of earned income estimated for the pet trust.[101] For Pat, statutory pet trust options had lower income taxes compared to a traditional trust with all income distributed. Both types of trusts could have problems in distributing enough income to the caregiver to cover the pet's expenses, pay for the caregiver's time, and cover the income taxes. This is especially so in situations where the caregiver is only being reimbursed for expenses and does not make any money from caring for the pet.[102] But the smaller the amount of distributions made to a human beneficiary, the less a costlier traditional pet trust makes sense for tax reasons alone—

101. *See* CNNMoney.com, *Does A Trust Make Sense?*, http://money.cnn.com/magazines/moneymag/money101/lesson21/index.htm (last visited Apr. 7, 2009).

102. *See supra* text accompanying notes 80–100.

even though more flexibility and control can be garnished through a traditional pet trust. However, the more likely all earned income will be distributed to care for the pet, the more likely that a traditional pet trust is superior to a statutory pet trust both in the personalization that can be accomplished with a traditional trust and under current federal income tax treatment of pet trusts.

5. Alternative Investment Strategies

For all three pet trusts, the trustee should also consider clever investing in instruments such as tax-free municipal bonds.[103] This option could be a tremendous way of reducing income tax liability for a trust in situations where the trust distributes to pay for pet reimbursement expenses. If, however, the money is intended as the caregiver's salary, the caregiver will still owe income taxes but the trust will not. In addition, another option is for the assets to be invested for growth instead of income; however, income tax may be owed when assets are sold.[104] But the practicality of investing in either tax-free municipal bonds or growth instead of income could make these options less attractive upon a closer look. The fact that Leona Helmsley made headlines with her $12 million pet trust shows how rare this type of gift is. More likely, most pet owners will leave a few thousand, as Pat did, and the choices will be much simpler.[105]

B. *State Income Tax*

Forty-three states and the District of Columbia tax personal income under varying rules, exemptions, and rates.[106] For exam-

103. *See* I.R.C. § 103 (2006); *see also* Abert, *supra* note 6, at 20. If a trust is invested in tax-free municipal bonds, then the income earned would be treated as tax free income and not subject to income tax. I.R.C. § 103.

104. *See* I.R.C. §§ 1(h), 1001, 1221(a); Abert, *supra* note 6, at 20.

105. The annual cost of a small dog is $580, a medium dog is $695, and a large dog is $875. Am. Soc'y for the Prevention of Cruelty to Animals, Pet Care Costs, http://www.Aspca.org/adoption/documents/pet_care_costs.pdf (last visited Apr. 7, 2009). The annual cost of a cat is approximately $670. *Id.* The annual cost of a horse is approximately $3,728.50. AllAboutHorses.com, Horse Care—Budgeting for a Horse, http://www.allabouthorses.com/horse-care/horse-budget.html (last visited Apr. 7, 2009).

106. *See* Eric A. Ess, *Internet Taxation Without Physical Representation?: States Seek Solution To Stop E-Commerce Sales Tax Shortfalls*, 50 ST. LOUIS U. L.J. 893, 921 & n.258 (2006) (explaining that there are forty-two states and the District of Columbia that have a state income tax). Although the article states that Tennessee does not have an income tax,

ple, California's income tax starts at a flat rate of 1% of personal income plus 2%–9.3% additional income tax depending on one's tax bracket, which would affect the traditional trust's beneficiaries.[107] Similar to California, New York also has a state income tax for personal income and a state income tax for the income earned in a trust.[108] State income taxes on trusts would add additional tax liability to the beneficiary pet or the beneficiary individual, and generally complement the analysis provided in the scenarios for federal income tax of trusts provided in Part III.A.4.[109]

Texas, South Dakota, Wyoming, Washington, Nevada, Florida, and Alaska do not have state income tax on personal income.[110] In addition, states such as New Hampshire and Tennessee, which do not have a personal income tax or limit the personal income tax to very specific situations, do impose a tax on the payment of certain dividends or interest earned by a trust that could add additional tax liability.[111] Thus, pet trusts will have income tax ramifications in a majority of states.

IV. GIFT TAXATION OF PET TRUSTS

The creation of an inter vivos pet trust may subject the pet owner (the donor) to gift tax at both the federal and state levels. However, as this section explains, the average pet owner probably will not be affected by federal or state gift taxes. This is because, unlike the federal income tax—which affects pet trusts once one

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in fact, it imposes an income tax on interest and dividends. *See* TENN. CODE ANN. § 67-2-102 (2006).

107. *See* CAL. REV. & TAX CODE § 17041 (West 1994 & Supp. 2009).

108. *See* N.Y. TAX LAW §§ 290, 601 (Consol. 1990 & Supp. 2009). Other states have equally interesting applicable statutes but this article focuses on California, Texas, New York and Florida due to their high number of retirees and pet owners, who will sooner trigger the situations discussed in this article.

109. *See generally supra* Part III.A.

110. *See* 2009 State Tax Handbook (CCH) 261, 263, 269, 273–74, 275 (2008) [hereinafter Tax Handbook]; Retirement Living Information Center, Taxes by State, http://www.retirementliving.com/RLtaxes.html (last visited Apr. 7, 2009) [hereinafter Retirement Living Report]. Under sections 220.03 and 220.11 of the Florida Code, only corporations, including common-law declarations of trust, are taxed at a basic rate of 5.5% of net income depending on the application of the federal alternative, but no personal income tax exists. *See* FLA. STAT. ANN. §§ 220.03, 220.11 (West 2005 & Supp. 2009).

111. *See* N.H. REV. STAT. ANN. §§ 77:1, :3 (2001 & Supp. 2008) (applying a 5% tax rate on certain types of income); TENN. CODE ANN. § 67-2-102 (2006) (applying a 6% tax rate on particular types of interest and dividend income applicable to trust).

dollar of income is produced, gift taxes apply only once the amount gifted exceeds a much higher threshold.

A. *Federal Gift Tax*

If the donor does not retain the ability to revoke the pet trust created during the donor's lifetime, the money or property used to fund the trust is a gift that is "transferred," and thus potentially subject to federal gift tax.[112] A gift is taxed based on its value—the amount a willing seller would take from a willing buyer—at the time of the gift.[113] A pet trust established inter vivos triggers a gift tax for the pet owner.[114] The term "taxable gifts" is defined in the I.R.C. as the "total amount of gifts made during the calendar year," minus the deductions provided for in §§ 2522 and 2523.[115] Gift taxes on the donor's taxable contributions to the trust might be eligible to offset the gift tax credit which, as of 2008, is $345,800.[116] Because charitable remainders of pet trusts are not recognized by the IRS, it seems unlikely that a gifted pet trust would qualify for a charitable gift tax deduction if the remainder beneficiary of the trust is a charity.

Example—AJ's Gift Tax

Worried that a testamentary trust will lock up necessary funds for Max and Charlie, AJ sets up an inter vivos pet trust. In 2008, AJ creates a trust, assigns Max and Charlie as the beneficiaries, and transfers $1 million without retaining control. At the end of 2008, assuming AJ has made no other taxable gifts in 2008, AJ's federal gift tax liability would be $345,800.[117] If AJ has not made taxable gifts in prior years, no tax would be owed on the transfer. Based on case law, statutory research, and the lack of clear guidelines for gift tax purposes, it does not seem to matter whether a

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112. I.R.C. § 2501(a)(1) (2006). Section 2001(c)(1) defines the rate schedule with the first level of the gift at $10,000 or under computed at 18%. *Id.* § 2001(c). The graduated rate increases up to the maximum level of any excess over $2,500,000 is taxed at 50%. *Id.*

113. *See* Treas. Reg. § 25.2512-1 (as amended in 1992); *see also* I.R.C. § 2512(a).

114. I.R.C. §§ 2501, 2511(a).

115. *Id.* § 2503(a). The allowable deductions are for gifts to charity and for gifts to a spouse. *Id.* §§ 2522–2523.

116. This figure is reached by applying the federal estate tax rates to the $1 million exemption amount. *Id.* §§ 2010(c), 2505(a).

117. *Id.* §§ 2001(c)(1), 2010, 2505(a).

traditional, statutory, or honorary pet trust is used. Instead, no matter which trust is picked, income and estate tax planning will be affected.[118]

B. *State Gift Tax*

As compared with state income taxes, which are imposed in a majority of states, only a dwindling handful of states retain their state gift tax statutes. The trend of imposing a state gift tax has continued to decline, with Louisiana and North Carolina being the latest states to repeal their gift taxes, effective January 1, 2009.[119] Only Connecticut and Tennessee retain a state gift tax.[120] In Connecticut, the gift tax is imposed on residents or nonresidents on a rate table from 1%–6%.[121] Tennessee's gift tax threshold is based on the relationship between donor and recipient.[122] While Louisiana's and North Carolina's gift tax exclusions were tied to federal gift tax exclusion and indexed for inflation, similar provisions are not provided in Tennessee's statutes.[123] However, Connecticut's gift tax is tied to the federal gift tax exclusion.[124] Tennessee's gift tax statutes create two classes of recipients: Class A for family members—spouse, children, lineal relations, etc.—and Class B for everyone else.[125] A gift given by a married individual is treated as coming equally from each spouse, while the annual gift tax exemption will change depending on whether there are Class A or Class B gift recipients.[126] Tennessee also has a gift tax range which spans from 5.5%–9.5% for Class A and 6.5%–16% for Class B.[127]

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118. *See supra* Part III.

119. LA. REV. STAT. ANN. § 47:1201 (2006) (repealed 2008); N.C. GEN STAT. § 105-188(a) (2007) (repealed 2009).

120. *Compare* JUDITH LOMAN, STATE GIFT TAX THRESHOLDS, http://www.cga.ct.gov/2005/rpt/2005-R-0283.htm (last visited Apr. 7, 2009) (listing the states that retain a gift tax as of 2005), *with* LA. REV. STAT. ANN. § 47:1201 (2006) (repealed 2008), *and* N.C. GEN STAT. § 105-188)(a) (2007) (repealed 2009) (repealing their gift taxes).

121. *See* CONN. GEN. STAT. ANN. §§ 12-640, 12-642 (West 2008).

122. *See* TENN. CODE ANN. §§ 67-8-102, -104 (2006).

123. *See* LA. REV. STAT. ANN. § 47:1205 (2006) (repealed 2008); N.C. GEN. STAT. § 105-188(d) (2007) (repealed 2009); TENN. CODE ANN. § 67-8-104 (2006).

124. *See* CONN. GEN. STAT. ANN. § 12-643(a) (West 2008); *see also* I.R.C. § 2503(b) (2006).

125. TENN. CODE ANN. § 67-8-102 (2006).

126. *See id.* §§ 67-8-104, -105.

127. *Id.* § 67-8-106.

V. ESTATE TAXATION OF PET TRUSTS

An estate tax is the tax on an individual's privilege of transferring property upon death.[128] The creation of a testamentary pet trust may subject a pet owner's estate to estate tax at both the federal and state levels. As with the gift tax discussed above, however, the average pet owner will probably not be affected by federal or state estate taxes.

A. *Federal Estate Tax*

Because "[t]he value of the gross estate include[s] the value of all property to the extent of the interest therein of the decedent at the time of his death,"[129] property which the pet owner leaves to a testamentary pet trust is potentially subject to the estate tax.[130] This is true even if the assets left behind are municipal bonds, which only escape income tax, not estate transfer tax.[131] Nonprobate assets used to fund the trust—for instance, a trust being named the beneficiary of the pet owner's life insurance policy, retirement plan, or annuity—are outside the scope of this article. Again, the type of trust does not seem to make a difference for these purposes.

Example—AJ's Estate Tax

AJ wants to provide for Max and Charlie so AJ creates a $1 million pet trust for their lifetime benefit and names Anne as the caregiver. As is common in pet trusts (including possibly Leona Helmsley's trust for Trouble),[132] pet owner AJ names "We Help Pets," a qualified charitable organization that assists animals, as

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128. John A. Miller & Jeffrey A. Maine, *Fundamentals of Estate Tax Planning*, 32 IDAHO L. REV. 197, 199 (1996).

129. I.R.C. § 2033 (2006).

130. *See id.* § 2001 ("A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.").

131. *See id.* § 2033 ("The value of the gross estate . . . include[s] the value of *all* property . . . .") (emphasis added).

132. *See* Dareh Gregorian, *Screw the Pooch*, N.Y. POST, June 16, 2008, at 3, *available at* http://www.nypost.com/seven/06162008/news/regionalnews/screw_the_pooch_115715.htm; Stephanie Strom, *Helmsley Left Dogs Billions in Her Will*, N.Y. TIMES, July 2, 2008, *available at* http://www.nytimes.com/2008/07/02/us/02gift.html?_r=1&partner=rssnyt.

the remainder beneficiary. After AJ's death, the $1 million pet trust would be included in AJ's estate, even if the trust qualified as a charitable remainder exception trust because of Revenue Ruling 78-105.[133]

Most estates will not need to worry about the federal estate tax, as the exemption for an estate is currently at $2 million and will increase to $3.5 million in 2009.[134] However, if the estate exceeds the exemption amount, the tax rate can be as high as 45% in 2007, 2008, and 2009.[135] So if AJ's estate is valued over $2 million when she creates a $1 million pet trust for Max and Charlie, then the tax bill could be as high as $450,000 on the $1 million trust.[136] If AJ has a large estate or has not already exhausted her applicable credit amount, she should consider an inter vivos pet trust. Under current rates, a $1 million gift incurs a tax liability of $345,800 under the federal gift tax statutes compared to a $450,000 tax liability under the current estate tax rate for a multi-million dollar estate.[137]

B. *State Estate Tax*[138]

Unlike the rarity of a state gift tax, most states have a type of state estate tax, including California, Florida, New York, and Texas.[139] A few states do not have a state estate tax.[140] There are three common state estate taxes: (1) the pick-up tax; (2) estate

133. *See* Rev. Rul. 78-105, 1978-1 C.B. 295, 296.

134. I.R.C. § 2010(c).

135. *Id.* § 2001(c)(2)(B).

136. *Id.* §§ 2001(c)(2)(B), 2010(c) (computing $1 million multiplied by 45%).

137. *See id.* § 2001(c).

138. As the four most populous states in the country (California, Texas, New York, and Florida), these states' estate and gift tax laws are examined with the assumption that many pet owners will be located in one of these areas. *See* U.S. CENSUS BUREAU, PUB. NO. NST-EST2008-01, ANNUAL ESTIMATES OF THE RESIDENT POPULATION FOR THE UNITED STATES, REGIONS, STATES, AND PUERTO RICO: APRIL 1, 2008 TO JULY 1, 2008, *available at* http://www.census.gov/popest/states/NST-ann-est.html.

139. *See* CAL. REV. & TAX. CODE § 13302 (West 1994); FLA. STAT. ANN. § 198.02 (West 2005); N.Y. TAX LAW § 952 (Consol. Supp. 2007); TEX. TAX CODE ANN. § 211.051 (Vernon 2008). However, because Texas has not "decoupled," there is effectively no estate tax in Texas at the present time. *See* TEX. TAX CODE ANN. § 211.051 (Vernon 2008); Susan Combs, Texas Comptroller of Public Accounts, Your Estate Under Texas Law (Dec. 2005), http://www.window.state.tx.us/taxinfo/taxpubs/tx96_127.html.

140. *See* Retirement Living Report, *supra* note 110.

tax on the ability or privilege to transfer property; and (3) estate tax on those inheriting property.[141]

The pick-up tax, as applied to the federal estate tax credit or offset, should not increase an estate's tax bill.[142] A significant number of states have this type of state estate tax.[143] Because the federal estate tax credits an estate for state taxes paid, if a state did not have this type of estate tax, the amount owed would be the same, but all taxes would be paid to the federal government instead of split between the federal and state governments.[144] Because the amount of estate tax owed does not increase, there should be no effect on pet trusts under these types of state estate statutes.[145]

The second type of state estate tax, the tax on transfer of property at death, is similar to the application of the federal estate tax discussed above, but with state-by-state differences for exemptions and deductions.[146] The pet owner's estate would incur additional state tax liability for pet trusts created.

The third category, taxing the heir or beneficiary, operates much like a gift tax, and the amount owed is often determined by how closely related the testator and the heir are. This is due to the exemptions and deductions provided by state law for family members.[147] A few states have an inheritance tax.[148] Using this state estate tax structure, pet trusts would also incur additional state tax liability.

If AJ or Pat are living in a state with the pick-up estate tax, they would not notice any additional tax burden.[149] Under both the second and third categories, practitioners should research their state's gift and estate tax law. If a state does not have a

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141. *See generally* Tax Handbook, *supra* note 110.

142. *See* 42 AM. JUR. 2D *Inheritance, Estate, and Gift Taxes* § 61 (2000). However, the federal government now treats state death taxes as a deduction instead of a credit, and many states, including Texas, have not "fixed" their tax law to provide for a substitute. I.R.C. § 2058; *see, e.g.*, TEX. TAX CODE ANN. § 211.051 (Vernon 2008).

143. *See, e.g.*, CAL. REV. & TAX. CODE §§ 13301–02 (West 1994) (imposing an estate tax on the amount applicable under federal estate tax law).

144. *See generally* Tax Handbook, *supra* note 110.

145. *See* 42 AM. JUR. 2D *Inheritance, Estate, and Gift Taxes* § 61 (2000).

146. *See e.g.*, CONN. GEN. STAT. ANN. § 12-391(g) (West 2008); WASH. REV. CODE ANN. § 83.100.040 (West 2006).

147. *See generally* Tax Handbook, *supra* note 110.

148. *See id.* at 66, 96, 101, 108, 123, 152, 198, 211.

149. *See supra* notes 142–44 and accompanying text.

state gift tax statute—as most states do not[150]—but has a state estate tax of the second or third category, the pet owner could reap tax savings by establishing an inter vivos pet trust that would not be subject to either federal or state estate taxes. Under any of the three state estate taxes, pet owners should seek a local tax practitioner for planning advice and details about the effect of her state estate tax.

C. *Charitable Remainder Exception*

A charitable remainder passes to an authorized charitable organization after the trust's original purposes ceases.[151] Generally, a decedent's estate may obtain an estate tax deduction for the value of a remainder interest passing to a charity if the requirements of a charitable remainder unitrust or charitable retained annuity trust are satisfied.[152] A charitable retained annuity trust ("CRAT") has several specific requirements.[153] Amounts must be distributed on a scheduled basis with 5% or more of the trust's corpus being distributed annually or more frequently.[154] The original amount of the trust is set from the beginning with no additional contributions permitted.[155] Moreover, when the trust terminates, 10% of the original value must have been preserved.[156] If all these requirements are fulfilled, a deduction for the original amount invested is allowed.[157]

With normal trusts, a deduction is given for testamentary gifts left to qualified charitable organizations.[158] However, in Revenue Ruling 78-105, the IRS stated that amounts passing to a pet trust for the lifetime benefit of a pet do not qualify for the charitable deduction given under the estate tax.[159] This ruling even affects those pet trusts which name a qualified charity as its remainder

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150. *See supra* Part IV.B.

151. *See* I.R.C. § 664(d)(1)(c)–(d)(2)(c) (2006).

152. *See* I.R.C. §§ 664, 2055(a), (e)(2).

153. Richard W. Kozlowski, Charitable Trusts (CRATS & CRUTS), http://www.vermontestateplan.com/charity.html (last visited Apr. 7, 2009).

154. *Id.*

155. *Id.*

156. *See* I.R.C. § 664(d)(1)(D).

157. *See* Kozlowski, *supra* note 153.

158. I.R.C. § 2055(a)(2).

159. Rev. Rul. 78-105, 1978-1 C.B. 295, 296.

beneficiary.[160] In Revenue Ruling 78-105, the decedent left a trust with trustee instructions to pay a certain monthly amount for pet expenses, and upon the pet's death, for the trust to terminate with the remainder paid to a designated charity.[161] Three situations were considered based on these facts.[162] The decedent in example one was a resident of a state that permitted a trust for a pet's care.[163] In example two, the decedent resided in a state where a pet trust was valid but merely honorary, because no statute existed that allowed a beneficiary to enforce the trust.[164] In the third and final example, the decedent resided in a state in which a pet trust was void at its inception.[165] The IRS held that no charitable deduction would be allowed in either example one or example two.[166] The IRS determined that a trust for the care of a pet does not fulfill §§ 664(d)(1) and 2055(e)(2) of the I.R.C.[167] Interestingly, in example three for federal tax purposes, the pet trust did fulfill the requirements of the I.R.C.—because void from its inception, the remainder interest was accelerated and the present interest vested.[168] Thus, the value of the interest passed directly to the charity at the time of the decedent's death, and the trust would be allowed a charitable remainder exception deduction under § 2055(a) of the I.R.C.[169]

The charitable remainder exception should be a great tax planning tool for the pet owner—but it is not. A pet owner establishing a pet trust with a remainder that passes to a charitable organization cannot benefit from this federal law.[170] Because the pet beneficiary is not a person, the IRS has stated that a pet trust's remainder that transfers to a charitable beneficiary cannot benefit from the charitable remainder deduction.[171] Payments must be made to a person, and a pet is not a "named person or persons"

160. *See id.* at 295
161. *See id.*
162. *See id.*
163. *Id.*
164. *Id.*
165. *Id.*
166. *See id.* at 296.
167. *See id.*
168. *See id.*
169. *See id.*
170. *See id.*
171. *See id.* at 296.

under § 7701(a)(1) of the I.R.C.[172] Thus, the pet trust is excluded from this beneficial deduction.[173] Arguably, if a traditional trust that satisfies the CRAT rules is established with a human beneficiary and the trust is not for lifetime benefit of the pet, the charitable remainder exception might apply. The difficulty would be avoiding the IRS's interpretation of trust for the lifetime benefit of a pet under Revenue Ruling 78-105, which appears to be a trust whose money is used for the care of a pet.[174]

Example—AJ's Charitable Remainder

If AJ establishes a $1 million pet trust for Max and Charlie with the remainder passing to ABC Pet Sanctuary (a charitable organization), the trust is treated as a normal pet trust without any special tax deductions. [175] Interestingly enough, if AJ lives in a state that does not recognize pet trusts and the state declares the trust invalid, then the invalidation causes the "remainder interest contribution to the charitable institution to be accelerated (by reason of failure of the trust)."[176] This allows the charitable reminder to exist and also allows the entire amount to be a deductible charitable contribution from the estate.[177] In this situation, AJ's failed attempt at creating a trust would enable her estate to claim the $1 million as a charitable deduction from estate taxes.[178]

During the last decade, changes to this part of federal estate law have been proposed by Representative Earl Blumenauer.[179] These changes are known as the "Morgan Bill."[180] The Morgan

172. *See* I.R.C. §§ 664(d)(1)(A), 7701(a)(1) (2006) (defining a person as "construed to mean and include an individual, a trust, estate, partnership, association, company or corporation"); Treas. Reg. §§ 1.664-2(a)(3), 1.664-3(a)(3) (2008); *see also* Rev. Rul. 78-105, 1978-1 C.B. 295, 295–96.

173. *See* Rev. Rul. 78-105, 1978-1 C.B. 295, 296.

174. *See generally id.*

175. *See* I.R.C. § 501(c)(3) (2006) (recognizing that a pet sanctuary may qualify as a charitable organization).

176. Abert, *supra* note 6, at 22.

177. *See* Rev. Rul. 78-105, 1978-1 C.B. 295, 296.

178. *See id.*; Abert, *supra* note 6, at 21.

179. Abert, *supra* note 6, at 21; *see* H.R. 2491, 110th Cong. (2007); H.R. 1796, 107th Cong. (2001).

180. *See* Rick Miller, *Owners Setting Up Their Furred and Feathered Friends for Life: Pet Trusts Are a Business Opportunity that Financial Advisers May Be Missing*, INVESTMENT NEWS, Aug. 15, 2005, at 3.

Bill would allow an estate to deduct amounts transferred to a charitable remainder pet trust during a pet's lifetime with the remainder transferred to a recognized charitable organization.[181] This proposal would amend the I.R.C. to allow CRAT pet trusts to enjoy the charitable estate tax deduction of normal CRAT trusts.[182] However, the bill has not been the subject of any debate or congressional vote.[183]

VI. RECOMMENDATIONS

A. *For Practitioners*[184]

From a taxation standpoint, attorneys first must decide whether to create an inter vivos pet trust or a testamentary pet trust. Attorneys should consider the client's total lifetime gifts under the federal gift statute as well as any applicable state gift statutes for clients living in Connecticut or Tennessee.[185] If the client has a large estate, has not taken advantage of gift tax credits, or lives in a state with a harsh state estate tax, the inter vivos pet trust—traditional, honorary, or statutory—might save the owner's estate a hefty estate tax liability on both a federal and state level.[186] Practitioners should remember that the gift tax has a smaller exemption amount than the estate tax, but can result in lower tax liability because of the rate used under the right cir-

181. Abert, *supra* note 6, at 21; *see* H.R. 2491 § 1(c)(5).

182. *See* H.R. 2491 § 1(c)(5).

183. *See* Abert, *supra* note 6, at 21.

184. Practitioners can take several simple steps on behalf of their clients. *See* Gerry W. Beyer, Estate Planning for Non-Human Family Members, 4–8 (2009), http://www.professorbeyer.com/Articles/Pet_Trusts_02-12-2009.pdf. Pet owners should prepare and in some cases carry (1) an animal card, which contains the name, animal type, location, and special care instructions of the pet; (2) an animal document, which contains the information from the animal card and any additional details, and is stored with the estate documents; (3) a door sign to alert individuals of pets in the house; and (4) special instructions for the owner's power of attorney that authorize the agent to care for the pet and amounts to spend. *See id.* (showing detailed examples of formats for these documents).

185. *See supra* Part IV. From a non-taxation standpoint, the owner should also consider that advantages for an inter vivos trust include the following: (1) the pet trust is effective immediately and already working at the pet owner's death without waiting for probate courts, (2) funds are immediately available for pet care and needs, and (3) the trust can be nominally funded and an account created which names the trustee as the beneficiary to provide pet funds upon the owner's death. *See generally* Beyer, *supra* note 184, at 9.

186. *See supra* Parts IV–V.

cumstances.[187] If the client has a small estate, has used her gift tax credit, or can save tax liability after consulting with federal and state estate tax statutes, then a testamentary pet trust—traditional, honorary, or statutory—would be an appropriate, common choice.[188] Additionally, if the pet dies while the owner is still alive, arguably savings would exist on a testamentary trust that no longer needs to be established. [189] This is advantageous when compared to an inter vivos trust established and running up administrative costs but no longer needed.[190]

Next, a practitioner should consider the income tax ramifications of the traditional versus statutory pet trust and whether the settlor, the beneficiary, or the trust is better suited to pay the taxes. An honorary pet trust would only be established in the few remaining states that otherwise invalidate the pet trust.[191] Because these states would not recognize a statutory pet trust, an honorary pet trust or traditional trust with appropriate instructions is the practitioner's only choice.[192] Even though honorary pet trusts will pay more in income taxes than the traditional and statutory pet trusts, the pet owner will probably be happy that any trust at all will be allowed to care for their beloved pet.[193]

The traditional pet trust is more common due to the pet owner's increased control over the pet's care. Also, based on the analysis performed in Part III, income accumulated in the trust could obtain tax advantages for the pet trust because the traditional pet trust enjoys a deduction for distributions to the human beneficiary.[194] The fewer the distributions, the higher the tax liability owed by the trust with a traditional pet trust.[195] Moreover, if the traditional pet trust is established inter vivos, the settlor might have federal and state gift tax liability.[196] If the traditional pet trust is testamentary in nature, the settlor's estate might face

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187. *See* I.R.C. §§ 2010(c), 2505(a) (2006).
188. *See generally supra* Parts IV–V.
189. *See* Beyer, *supra* note 184, at 9.
190. *Id.*
191. *See supra* Part II.D.
192. *See id.*
193. *See supra* text accompanying note 79.
194. *See* Beyer, *supra* note 184, at 8; *supra* Part III.A.4.
195. *See supra* notes 74–78 and accompanying text.
196. *See supra* Part IV.

federal and state estate tax liability.[197] Finally, distributions to the human beneficiary under a traditional pet trust will incur tax liability for the beneficiary.[198] Thus, a traditional pet trust can trigger many of the tax liabilities for one, two, or all three of the classes of people affected when a pet trust is created—settlor, beneficiary, trust. If a traditional pet trust will annually distribute most or all of the income earned by the trust—and maybe even some of the corpus of the trust—and the beneficiary is in a low income tax bracket, the traditional pet trust could enjoy income tax advantages over the statutory pet trust for both the beneficiary and the trust.[199] Regardless, the settlor's ability to enjoy tax advantages under a traditional pet trust will depend upon the owner's estate and gift tax credits or available exemptions.[200]

On the other hand, if the corpus of the pet trust will be a small amount that cannot justify significant setup costs, and the difference in yearly tax is only $20 or $30 more than a traditional trust, then the statutory pet trust could be the better option for both the trust and the pet beneficiary.[201] First, an advantage to the trust clearly exists if a lower tax rate (married individual filing separately versus high trust rate) is used and the income of the trust is the only taxed income. Compare that to a human beneficiary of a traditional pet trust whose trust distributions would be stacked on top of presumably several thousand dollars in personal income, making it subject to higher rates.[202] In effect, the income is possibly taxed to the settlor when the pet trust is created or when the owner dies and taxed to the trust when income is earned because distributions to pets are not deductible.[203] Thus, the income should not incur tax liability at the beneficiary stage because the pet is not a person.[204]

A settlor can establish a statutory pet trust when the pet owner dies. Tax advantages could exist for the settlor to establish tradi-

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197. *See supra* Part V.

198. *See supra* Part III.A.2.

199. *See supra* Part III.A.4.

200. *See supra* Parts IV–V.

201. *See infra* notes 202–05 and accompanying text.

202. *See supra* Part III.A.4. This increased taxable income of the human beneficiary for the traditional pet trust would result in a higher tax rate and higher tax liability than under the statutory pet trust. *See id.*

203. *See supra* Part III.

204. *See supra* notes 40–43 and accompanying text.

tional inter vivos pet trusts in states not recognizing pet trusts if he or she has a large estate and a maximum tax rate higher than the gift tax rate. On the other hand, if a wealthy individual will not use all of his or her exemption amounts because most of the assets are non-probate assets, a statutory pet trust might be a tax advantageous option. Additionally, the longer the pet trust will last (i.e., parrot or horse), the more likely the start-up costs of a traditional inter vivos pet trust will be capitalized over the lifetime of the trust, especially if the annual income tax is less than a statutory pet trust.

B. *For Congress*

Congress should consider enacting the Morgan Bill.[205] The estate tax deduction would benefit pet owners' estates—especially because the traditional pet trust is a common way of establishing a pet trust.[206] It would also benefit charitable organizations, because one can assume charities would see an increase in contributions under the pet trust CRAT charitable remainder exception.[207] Congress could also extend the benefits to pet owners by allowing CRAT pet trusts to be exempted from income taxes on income and distributions during the lifetime of the pet because, in essence, the money is a charitable contribution once the pet passes away.[208]

VII. CONCLUSION

Favorable pet trust laws and modern developments are ushering an exciting time to be a practicing attorney. But amendments to tax laws for pet trusts and the associated complexities should cause practitioners to stop, ask their clients questions, and examine the federal and state tax advantages or disadvantages of the structured pet trusts. Each pet trust type has its own income,

205. *See supra* notes 179–83 and accompanying text; *see also* Jonathan P. Wilkerson, Comment, *A "Purr"fect Amendment: Why Congress Should Amend the Internal Revenue Code to Apply the Charitable Remainder Exception to Pet Trusts*, 41 TEX. TECH L. REV. 587, 607–11 (2009) (advocating for the adoption and passage of the Morgan Bill and outlining the benefits for pets and pet owners).

206. *See* Wilkerson, *supra* note 205.

207. *See id.*

208. *See id.*

gift, and estate tax considerations to ponder.[209] As baby boomers continue to retire, many of them pet owners who treat their pets as family members, practitioners should add "pet planning" to their list of estate planning services;[210] Ms. Helmsley's attorney did, and Trouble sure is thankful.[211]

209. *See supra* Parts III–V.

210. *See* Beyer, *supra* note 6, at 618; Zenov, *supra* note 16, at 22.

211. WashingtonPost.com, *Helmsley's Dog Gets $12 Million in Will*, WASH. POST, Aug. 29, 2007, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2007/08/29/AR2007082900491.html.