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DEDUCTIONS AVAILABLE ON INCOME TAX RETURNS OF TRUSTS AND ESTATES AFTER ENACTMENT OF SECTION 67(g)

By: Eva Lauer, Esq.

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I. Introduction

The *Tax Cuts and Jobs Act* has made the ability to deduct of previously deductible expenditures of a trust or of an estate unclear. Specifically, the *Tax Cuts and Jobs Act* suspends all miscellaneous itemized deductions from 2018 through 2025 by adding section 67(g) to section 67.[1] While both the *Tax Cuts and Jobs Act* and the *Tax Cuts and Jobs Act Conference Report to Accompany H.R. 1* (the *Conference Report*) state that miscellaneous itemized deductions are no longer deductible, neither clarify what the income tax consequences are for trusts or estates.[2] Further, neither Congress nor the Internal Revenue Service have issued guidance on this issue. The *Conference Report* merely lists items found under IRS Publication 529 as items subject to the 2-percent floor in its attempt clarify the section of the *Tax Cuts and Jobs Act*.[3]

Adding to the confusion resulting from the addition of section 67(g), the *Tax Cuts and Jobs Act* and the *Conference Report* describe the change in the law slightly differently. While the *Tax Cuts and Jobs Act* states that no miscellaneous itemized deductions are allowed, the *Conference Report* states that items that are subject to the 2-percent floor are suspended.[4] Although the difference seems minute, it could affect whether certain trust or estate items are deductible. The reason this brings confusion is that miscellaneous itemized deductions are simply defined as "itemized deductions other than" the items listed in section 67(b).[5] Since the definition simply lists what are not miscellaneous itemized deductions, miscellaneous itemized

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[1] *An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018* (*Tax Cuts and Jobs Act*), 115 P.L. 97, 131 Stat. 2054, 35 (2017) *available at* https://www.congress.gov/bill/115th-congress/house-bill/1/titles; I.R.C. § 67(a) (2018).
[2] *Tax Cuts and Jobs Act* at 35; *Tax Cuts and Jobs Act Conference Report to Accompany H.R. 1*, H.R. REP. NO. 115-466, at 274 (2017) (Conf. Rep), *citing* I.R.S. PUB. NO. 529 (2016), *available at* https://www.irs.gov/pub/irs-pdf/p529.pdf.
[3] H.R. REP. NO. 115-466, at 274, *citing* I.R.S. PUB. NO. 529. (2016)
[4] *Tax Cuts and Jobs Act* at 35; H.R. REP. NO. 115-466, at 274.
[5] I.R.C. §67(b) (2018).

deductions are not necessarily limited to the items subject to the 2-percent floor under section 67(a). As a result, the disallowance of all miscellaneous itemized deductions under *Tax Cuts and Job Act* could have a greater impact on section 67 than a disallowance subject to the 2-percent under the *Conference Report*.

While there is no guidance on the *Tax Cuts and Jobs Act*'s addition of section 67(g), which disallows miscellaneous itemized deductions, and the impact it has on trust and estate income tax returns, the ability to deduct of specific items of administration of trusts and estates has been analyzed in cases and regulations that can clarify in what subsection of section 67 the item falls.[6] Specifically, Regulation § 1.67-4, which was finalized in 2014 after several revisions as a result of differing case law, outlines which expenses and fees are subject to the 2-percent floor and which expenses and fees are not subject to the 2-percent floor.[7] These analyses, that came before the *Tax Cuts and Jobs Acts*, can help determine whether the items are still deductible while section 67(g) is in effect.[8]

Section II of this paper will discuss the likely applicability of particular subsections of section 67 that relate to trusts and estates to determine which items will still be deductible. Section III of this paper will discuss section 67(e)(1), the section that allows trusts and estates to deduct "costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate."[9] Using past guidance on section 67(e)(1) deductions, Section III will determine which items are fully deductible and therefore not disallowed by section 67(g). Section IV of this paper

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[6] Treas. Reg. § 1.67-4 (2018).
[7] *Id.*
[8] *Id.*
[9] § 67(e)(1)

discusses the applicability of section 67(e)(2), which allows deductions of specific items when computing the adjusted gross income of an estate or trust, after the *Tax Cuts and Jobs Act*.

II. Application of Section 67 After the *Tax Cuts and Jobs Act*

Miscellaneous itemized deductions are found under section 67 of the Code.[10] Before the enactment of the *Tax Cuts and Jobs Act*, taxpayers, including trusts and estates, could deduct miscellaneous items deductions that exceeded 2-percent of their adjusted gross income under section 67(a).[11] Specifically, section 67(a) provided that, "in the case of an individual, the miscellaneous itemized deductions for any taxable year shall be allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income."[12]

A temporary regulation that has been in place since 1988 provides a list of expenses subject the 2-percent floor under section 67(a).[13] Expenses subject to the 2-percent floor include "(i) Unreimbursed employee expenses,…(ii) Expenses for the production or collection of income for which a deduction is otherwise allowable under section 212 (1) and (2), such as investment advisory fees, … (iii) Expenses for the determination of any tax for which a deduction is otherwise allowable under section 212(3), such as tax counsel fees and appraisal fees, and (iv) Expenses for an activity for which a deduction is otherwise allowable under section 183," which is the deduction for property transferred in connection with performance of services.[14] IRS Publication 529 provides the same list of miscellaneous itemized deductions and specifies items that may be included as an expense subject to the 2-percent floor that fall under these categories.[15]

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[10] § 67.
[11] § 67(a).
[12] *Id*.
[13] Treas. Reg. § 1.67-1T (2018).
[14] *Id*.
[15] I.R.S. PUB. NO. at 2-8 (2017), *available at* https://www.irs.gov/pub/irs-pdf/p529.pdf.

Before the *Tax Cuts and Jobs Act,* taxpayers, including trusts and estates, could also deduct certain items that were not subject to the 2-percent floor listed under section 67(b).[16] Under section 67(b), "'miscellaneous itemized deductions' means the itemized deductions other than" a list of 12 items provided in section 67(b).[17]

While sections 67(a) and 67(b) pertain to itemized deductions allowed for individuals, section 67(e) applies to itemized deductions allowed for trusts and estates. Section 67(e) states:

> For purposes of this section, the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual, except that--
> (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate, and
> (2) the deductions allowable under sections 642(b), 651, and 661 [26 USCS §§ 642(b), 651, and 661], shall be treated as allowable in arriving at adjusted gross income. Under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter [26 USCS §§ 641 et seq.] to take into account the provisions of this section.[18]

Because the first part of section 67(e) says that an estate or trust is computed in the same manner as an individual, trusts and estates could take deductions allowed by sections 67(a) and 67(b) as well as section 67(e).[19] Additionally, a trust or estate was able to fully deduct costs that were incurred, notwithstanding the 2-percent floor, because the property was held by a trust or estate.[20] Trusts and estates were also provided a personal exemption that varied based on the type of trust or estate, and they were allowed distribution deductions.[21] Because of the way that section 67 is structured, it is not clear whether certain parts of section 67(e) are still deductible as they were before the *Tax Cuts and Jobs Act.* Section II, Subsection a of this paper will discuss

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[16] § 67(b),(e).
[17] § 67(b).
[18] § 67(e).
[19] *Id*.
[20] § 67(e)(1).
[21] *Id*.

the possible ways in which deductions under section 67(e) may have been affected by the *Tax Cuts and Jobs Act.*

a. Theories on the Ability to Deduct under Section 67 after the *Tax Cuts and Jobs Act*

Deductions for trusts and estates became unclear after the *Tax Cuts and Jobs Act*. Section 11045 of the *Tax Cuts and Jobs Act* suspended miscellaneous itemized deductions by adding a new section 67(g) to section 67, which provides, a "[suspension for taxable years 2018 through 2025" of miscellaneous itemized deductions.[22] Specifically, section 67 states, "[n]otwithstanding section 67(a), no miscellaneous itemized deduction shall be allowed for any taxable year beginning after December 31, 2017, and before January 1, 2026."[23] Rather than allowing miscellaneous itemized deductions in excess of the 2-percent floor, section 67(g) bars all miscellaneous itemized deductions.

There are several ideas about the effect of section 67(g) on section 67(e).[24] Since the new section 67(g) does not make specific reference to section 67(e), one argument is that section 67(e) allows trusts and estates to deduct all items that were previously deductible for trust and estates, including miscellaneous itemized deductions that are subject to the 2-percent floor.[25] Since the language of section 67(g) specifically says "Notwithstanding subsection (a), no miscellaneous itemized deduction shall be allowed," this argument is not likely to be successful.[26] As a result, section 67(g) is not limited to disallowing miscellaneous itemized deductions found under section 67(a). Further, neither the *Conference Report* nor the *Tax Cuts and Jobs Act* specify who the suspension applies to, making it appear to apply to individuals as

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[22] *Tax Cuts and Jobs Act* at 35.
[23] *Id.*
[24] Steve R. Akers, *Selected Highlights of 2017 Tax Act and Estate Planning Considerations* (January 19, 2018).
[25] *Id.* at 9.
[26] *Tax Cuts and Jobs Act* at 35.

well as trusts and estates.[27] As a result, the language indicates that trusts and estates will not be able to take all of the deductions previously allowed by section 67 because they may no longer deduct items subject to the 2-percent floor.

Another interpretation is that section 67(g) supersedes all of section 67(e).[28] It is not likely that Congress intended to exclude all of section 67(e) since allowing section 67(g) to fully supersede section 67(e) "would lead to illogical results."[29] Specifically, section 67(e)(2) allows trusts and estates to deduct distributions to beneficiaries.[30] Without allowing trusts and estates a deduction, there would be a double tax because a distribution would be taxed to the trust or estate and the beneficiary.[31] Suspending the provision would render the advantage of a trust useless and burden an estate.[32]

The most realistic result of the *Tax Cuts and Jobs Act* is that section 67(g) does not suspend any section of section 67. Instead, section 67(g) is an additional step in analyzing whether an expense is deductible. Specifically, instead of stating that subsection 67(a) is suspended, section 67(g) uses "notwithstanding subsection (a)."[33] As a result, section 67(g) does not change the analysis under section 67(e). Instead a deduction is determined under section 67(e) then, if a deduction is considered a miscellaneous itemized deduction, it is disallowed by section 67(g).

If section 67(g) is an additional step in analyzing the ability to deduct an expense, then section 67(g) in practice would only affect a small portion of section 67(e). The first sentence of

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[27] H.R. REP. NO. 115-466, at 274.
[28] Akers, *supra* note 24, at 9.
[29] *Id*.
[30] *Id*.
[31] *Id*.
[32] *Id*.
[33] § 67(g).

section 67(e) states that an estate or trust is treated like an individual.[34] Because section 67(a) and 67(b) are available to individuals, the deductions may be taken by trusts and estates. Since section 67(a) is disallowed by section 67(g), any expenses falling under section 67(a) incurred by a trust or estate is no longer deductible. However, deductions under section 67(b) would still be allowed since section 67(b) provides a list of itemized deductions that are not considered miscellaneous itemized deductions.[35]

Where the application of sections 67(g) to 67(e) becomes unclear is under sections 67(e)(1) and 67(e)(2). Section 67(e) provides exceptions to the default rule of being treated as an individual in determining the ability to deduct itemized deductions under sections 67(e)(1) and 67(e)(2). Section 67(e)(1) provides that certain costs "which would not have been incurred if the property were not held in such trust or estate" are deductible.[36] Deductions falling under this provision include trustee's fees and executor's or personal representative's fees and deductions of certain appraisal costs by an estate during administration, since they would not ordinarily be incurred if the property were held individually.[37] Section 67(e)(2) allows deductions to be fully taken under section 642(b) for personal exemption deduction and section 651 or section 661 for distribution deduction in computing the adjusted gross income of a trust or estate.[38]

The least likely outcome of sections 67(e)(1) and 67(e)(2) would be a disallowance of all deductions under both. As discussed, disallowing section 67(e)(2) deductions would be overly burdensome on trusts and estates.

[34] § 67(e).
[35] § 67(b).
[36] § 67(e)(1).
[37] § 67(e)(1).
[38]§ 67(e)(2).

Another possible interpretation of the newly enacted section 67(g) on existing sections 67(e)(1) and 67(e)(2) is that deductions listed in section 67(e)(2) remains deductible while section 67(e)(1) deductions are considered miscellaneous itemized deductions and therefore disallowed under section 67(g). Section 67(g) says miscellaneous itemized deductions are disallowed but it does not restrict the disallowance to miscellaneous itemized deductions subject to the 2-percent floor.[39] Looking to the definition of "miscellaneous itemized deductions," section 67(b) only provides that "miscellaneous itemized deductions are deductions other than" the list provided in section 67(b).[40] This definition means it is possible that miscellaneous itemized deductions are not limited to deductions under section 67(a) but could include other deductions within the section, such as the deductions under section 67(e)(1). For example, tax preparation fees for an estate would become deductible in arriving at gross income under section 67(e)(1). However, tax preparation fees are typically considered miscellaneous itemized deductions. As a result, if section 67(e)(1) deductions are still considered miscellaneous itemized deductions even though they are taken above the line, they would no longer be deductible.[41]

The final possible interpretation is that both sections 67(e)(1) and 67(e)(2) were not affected by section 67(g). Since the deductions allowable under sections 67(e)(1) and 67(e)(2) are considered "above-the-line" deductions, they are reclassified so that they are not considered miscellaneous itemized deductions.[42] If a taxpayer were to rely on the *Conference Report*, sections 67(e)(1) and 67(e)(2) were not affected by section 67(g) because they are not subject to the 2-percent floor.[43] Of the three possibilities, this interpretation is most likely. Since the

[39] § 67(g).
[40] § 67(b).
[41] § 67(g).
[42] Aker, *supra* note 24, at 9 *citing* Steve Gorin.
[43] H.R. REP. NO. 115-466, at 274.

Conference Report's purpose is to provide clarification on the *Tax Cuts and Jobs Act*, following the clarification that miscellaneous itemized deductions are those deductions subject to the 2-percent floor would be the best practice.

b. Most Likely Result of the *Tax Cuts and Jobs Act*

Tracking the code based on the assumption that section 67(e) still applies, a trust or estate expense would fall under either section 67(e), section 67(e)(1), or section 67(e)(2). If the expense falls under section 67(e)(1) or section 67(e)(2), it would still be deductible. If the expense does not fall under section 67(e)(1) or section (e)(2), a taxpayer must determine whether the expense would have fallen under section 67(a) or section 67(b) had the expense been borne by an individual. If the expense falls under section 67(b), the expense is still deductible. If the expense falls under section 67(a), section 67(g) will prevent a deduction for the expense.

With the implementation of section 67(g), taxpayers will need to determine what is still deductible. Additionally, fiduciaries may want to determine how to structure expenses so that they are still deductible. It may be prudent for fiduciaries to curb certain types of expenses that are no longer deductible. To determine whether or not a fee or expense is deductible, Sections III and VI of this paper discuss the ability to deduct certain administration fees and expenses in trusts and estates.

III. Deductions Available Under Section 67(e)(1)

As discussed in Section II, there is a possibility that items falling under both section 67(a) and section 67(e)(1) are disallowed while section 67(g) is in effect. Assuming deductions under section 67(e)(1) are still allowed, Regulation § 1.67-4 provides guidance on what a trust or estate may still deduct under section 67(e)(1) on its income tax return.[44] Section 67(e)(1) provides a

[44] § 1.67-4(a).

deduction for "costs which are paid or incurred in connection with the administration of the estate or trust and which would not have been incurred if the property were not held in such trust or estate." [45] The regulations clarify that a "cost is subject to the 2-percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust, and commonly or customarily would be incurred by a hypothetical individual holding the same property."[46]

In deciding whether a fee or expense is fully deductible under section 67(e)(1), reviewing the development of the interpretation of section 67(e)(1) may be helpful. While Regulation § 1.67-4 was finalized in 2014, there were a series of proposed regulations with varying rules on the deduction of expenses under section 67(e)(1) that came in the years prior to the final version of the regulation.[47] Additionally, there were also several conflicting cases that ultimately contributed to the finalized regulation.[48]

In the first case to discuss section 67(e)(1), *O'Neill v. Commissioner*, the Six Circuit Court of Appeals held that "certain expenditures unique to trust administration are excepted from the two percent floor," which created a "but for" test to determine whether section 67(e)(1) allows a deduction.[49] Several years after *O'Neill* was decided, the Federal Circuit Court concluded in *Mellon Bank v. U.S.* that fees were not deductible under section 67(e)(1) because the court thought section 67(e)(1) needed to be read in conjunction with section 67(e)(2).[50] Since section 67(e)(2) "treats as fully deductible only those trust-related administrative expenses that

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[45] § 67(e)(1).
[46] § 1.67-4(a).
[47] Carol A. Cantrell, *Summary of the Final Section 67(e) Regulations (2014)*, https://www.americanbar.org/content/dam/aba/events/real_property_trust_estate/nclcf/2014_06/nclcf_2014_06_03_section_67e_commentary.authcheckdam.pdf.
[48] *Id.*
[49] *O'Neill v. Comm'r*, 994 F.2d 302, 303 (6th Cir. 1993); Cantrell, *supra* note 47, at 1.
[50] *Mellon Bank, N.A. v. United States*, 265 F.3d 1275 (Fed. Cir. 2001).

are unique to the administration of a trust and not customarily incurred outside of trusts," the Court held that fees that are "commonly incurred outside of trusts," such as investment advice and management fees, are not deductible under section 67(e)(1).[51] In *Scott v. U.S.* the Fourth Circuit Court of Appeals relied on *Mellon Bank* in its holding, while similarly disagreeing with the holding in *O'Neill*.[52]

In *Rudkin Testamentary Trust v. Commissioner*, the Second Circuit Court of Appeals disagreed with the holdings in *O'Neill, Mellon Bank*, and *Scott*, creating its own test to determine whether deductibility under section 67(e)(1).[53] The court stated that it must "determine with certainty that costs could not have been incurred if the property were held by an individual. [It] therefore h[e]ld that the plain meaning of the statute permits a trust to take a full deduction only for those costs that could not have been incurred by an individual property owner."[54]

Considering the cases and advice submitted by tax practitioners, the Treasury drafted the first iteration of proposed regulation § 1.67-4, using the *Rudkin* analysis to determine whether fees and expenses incurred by a trust or estate were allowed a deduction under section 67(e)(1).[55] However, shortly thereafter, the Supreme Court rejected *Rudkin,* requiring the Treasury to amend its proposed regulation.[56]

In *Knight v. Commissioner*, the Supreme Court discussed how to determine whether a fee or expense is subject to the 2-percent floor or whether it could be fully deducted under section 67(e)(1).[57] In *Knight,* a trustee argued that investment advisory fees were not subject to the 2-percent floor of section 67(a) because they were incurred to satisfy the trustee's fiduciary

51 *Mellon Bank*, 265 F.3d at 1281.
52 *Scott v. United States*, 328 F.3d 132, 140 (4th Cir. 2003).
53 *William L. Rudkin Testamentary Tr. v. Comm'r,* 467 F.3d 149 (2d Cir. 2006).
54 *Rudkin,* 467 F.3d at 156.
55 Candrell, *supra* note 47, at 1.
56 *Id*.
57 *Knight v. Comm'r*, 552 U.S. 181 (2008).

obligation of prudent investment.[58] The Supreme Court disagreed, holding that the fees were subject to the 2-percent floor because section 67(e)(1) provides an exception to the 2-percent floor when the costs are not commonly incurred by an individual.[59] Specifically, "[i]n asking whether a particular type of cost 'would not have been incurred' if the property were held by an individual, section 67(e)(1) excepts from the 2% floor only those costs that it would be uncommon (or unusual, or unlikely) for such a hypothetical individual to incur."[60] Since an individual may seek advice from an investment advisor, and since a trustee is obligated to invest in the same manner as a prudent individual investor, the fees were not unique to a trust and would be subject to the 2-percent floor.[61]

Using the Supreme Court's decision in *Knight*, the Treasury amended its proposed regulation, which was later altered slightly before its final implementation of the regulation in 2014.[62] Specifically, the final regulation provides that "[a] cost is subject to the 2-percent floor to the extent that it is included in the definition of miscellaneous itemized deductions under section 67(b), is incurred by an estate or non-grantor trust, and commonly or customarily would be incurred by a hypothetical individual holding the same property."[63] Generally, looking at the actual product or service rendered, not the description of that product or service matters in determining whether the cost is deductible.[64]

The list of fees and expenses provided below follows § 1.67-4 to determine whether the fees and expenses would still be deductible as a result of section 67(g), assuming section 67(g)

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[58] *Knight*, 552 U.S. at 183.
[59] *Id*.
[60] *Id.* at 192.
[61] *Id* at 183.
[62] Cantrell, *supra* note 47, at 1.
[63] § 1.67-4(a).
[64] § 1.67-4(b)(1).

allows deductions provided in section 67(e)(1) and disallows deductions provided in section 67(a).

a. Investment Advisory Fees

While the Supreme Court in *Knight* said investment advisory fees are subject to the 2-percent floor, under Regulation § 1.67-4, some investment advisory fees may be not be subject to the 2-percent floor and may therefore still be deductible.[65] § 1.67-4(b)(4) states:

> Certain incremental costs of investment advice beyond the amount that normally would be charged to an individual investor are not subject to the 2-percent floor. For this purpose, such an incremental cost is a special, additional charge that is added solely because the investment advice is rendered to a trust or estate rather than to an individual or attributable to an unusual investment objective or the need for a specialized balancing of the interests of various parties (beyond the usual balancing of the varying interests of current beneficiaries and remaindermen) such that a reasonable comparison with individual investors would be improper. The portion of the investment advisory fees not subject to the 2-percent floor by reason of the preceding sentence is limited to the amount of those fees, if any, that exceeds the fees normally charged to an individual investor.[66]

The *Conference Report* also discusses investment advisory fees, indicating that "investment fees and expenses" and "service charges on dividend reinvestment plans" are no longer deductible.[67] These fees would logically be disallowed a deduction under section 67(g) for trusts and estates without specification since they are all fees that "commonly or customarily would be incurred by a hypothetical individual holding the same property."[68] Therefore they would not fall under section 67(e)(1) and would be subject to the 2-percent floor under section 67(a).

As a result of the *Tax Cuts and Jobs Act*, investment advisory fees would be subject to the 2-percent floor since they would be commonly or customarily incurred had the property

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[65] § 1.67-4(b)(4).
[66] *Id*.
[67] H.R. REP. NO.115-466, at 274.
[68] § 1.67-4(a).

invested been held by an individual. Using the analysis of section 67, under section 67(e), the trust or estate would be treated as an individual, allowing a deduction for the fee under section 67(a). As a result, under section 67(g) they would not be deductible if they were incurred after December 31, 2017 and before January 1, 2026.

For investment advisory fees rendered to a trust or estate that are not commonly or customarily incurred by an individual, such as a separate fee an investment advisor charges to trusts, the fees would be deductible because they would fall under section 67(e)(1) and would not be subject to section 67(g). Investment advisors should apportion fees in their bill so that a fiduciary may deduct the portion of investment advisory fees that are still deductible under section 67(e)(1). Apportionment of such fees are addressed further in Section III, Subsection h of this paper.

b. Tax Preparation Fees

Generally, for individuals, tax preparation fees are miscellaneous itemized deductions subject to section 67(a) and are therefore disallowed by section 67(g).[69] The *Conference Report* lists specific items that were previously deductible but are no longer allowed by section 67(g).[70] One of the items listed is tax preparer fees for regular income tax purposes.[71] Individuals were no longer "allowed an itemized deduction for expenses for the production of income. These expenses are defined as ordinary and necessary expenses paid or incurred in a taxable year: (1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax."[72] The *Conference Report* borrowed language from section 212,

[69] § 67(a), (g).
[70] H.R. REP. NO.115-466, at 273.
[71] *Id.*
[72] *Id.*

which allows the tax preparer deduction for businesses.[73] As a result, nonbusiness related tax preparer fees for individuals that were deductible under section 67(a) above the 2-percent limit are disallowed by section 67(g), effectively suspending the deduction for tax preparation fees incurred by individuals unless the fees are related to a business.[74] Where an individual taxpayer paid a tax preparer to prepare a return that involves business and nonbusiness income, the taxpayer would need to apportion the fees.

Unlike tax preparation fees for individuals which are mostly disallowed under section 67(g), tax preparation fees for estates are not disallowed by section 67(g).[75] Tax preparation fees and costs "relating to all estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax returns are not subject to the 2-percent floor" since they would not be commonly or customarily incurred by an individual.[76] As a result, under the *Tax Cuts and Jobs Act*, fees incurred on such returns would still be deductible since they fall under section 67(e)(1), which is not affected by section 67(g). Two types of returns are excluded from the list under § 1.67-4(b)(3) as a deductible under section 67(e)(1) are the decedent's gift tax returns (Form 709) and the decedent's "final FBAR (Form 114a)."[77]

Tax preparation fees are probably still allowed for trusts. While a tax preparation fee is commonly or customarily incurred by an individual holding property which ordinarily would prevent the fee from deduction under section 67(e)(1), in discussing tax preparation fees under § 1.67-4(b)(3), the Treasury includes "fiduciary income tax returns" as a deductible item under section 67(e)(1). Since a fiduciary income tax return is Form 1041, which is the income tax

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[73] I.R.C. §212 (2018).
[74] H.R. REP. NO. 115-466, at 273.
[75] § 1.67-4(b)(3).
[76] *Id*.
[77] Cantrell, *supra* note 47, at 6.

return for estates and trusts, tax preparation fees attributable to a trust would be deductible under section 67(e)(1).

Because a tax preparer often prepares several different tax returns for a single client, the tax preparer would need attribute the fees to each particular tax return so that the fees are deducted only to the extent still allowed by section 67(g).

c. Fiduciary's Fees

Generally, trustee's fees or executor's fees remain deductible under the *Tax Cuts and Jobs Act*. Trustee's fees and executor's fees fall under section 67(e)(1) because the fees would not be commonly or customarily incurred by a hypothetical individual holding the same property since an individual would not have a trustee or executor.[78] Trustee's fees are only incurred because property is held in a trust. Similarly, executor's fees are only incurred because of the estate administration. As a result, trustee's fees and executor's fees would typically not be subject to the 2-percent floor.

While trustee's fees and executor's fees are typically deductible under section 67(e)(1), the *Conference Report* says that "fees to collect interest and dividends" are subject to the 2-percent floor and disallowed by section 67(g).[79] As a result, a trustee or executor who collects interest or dividends for a trust or estate would not be able to deduct the fees related to that collection. To deduct of a portion of the trustee's fees or executor's fees, the trustee or executor would need to separate those fees that are deductible from those that are not deductible. The trustee or executor may also need to separate fees attributable to investment advice.

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[78] § 1.67-4(a).
[79] H.R. REP. NO. 115-466, at 274.

The *Conference Report* also says that "trustee's fees for an IRA, if separately billed and paid" are no longer deductible.[80] The *Conference Report* took this language from IRS Publication 529 as a type of fee that was subject to the 2-percent floor.[81] This likely only disallows fees that the trustee of an IRA charges individuals, not trustee's fees for a trust of other types of property.

Fiduciary fees paid as a result of a judgment are also deductible under section 67(e)(1).[82] In *New York Trust Company v. United States*, a trustee sought a refund for a deficiency assessed on a trust.[83] As a result of settlement with the executors of the decedent's estate, the trustee paid the executors for work performed on property before the property was turned over to the trust, deducting them on the trust's tax return.[84] The court partially allowed the deductions of the payments of fees "attributable to income of assets of the estate turned over by the executors to the testamentary trustee."[85]

For the most part, fiduciary fees are deductible after the *Tax Cuts and Jobs Act.* Although these fees are deductible, fiduciaries who provide services that may not be deductible under section 67(e)(1) should apportion their fees accordingly so that only fees deductible under section 67(e)(1) are deducted. This apportionment will be discussed further in Section III, Subsection h of this paper.

d. Expenses of Administration

[80] *Id*.
[81] I.R.S. PUB. NO. 529, at 9 (2017).
[82] *N.Y. Tr. Co. v. United States*, 115 F. Supp. 661 (S.D.N.Y. 1953).
[83] *Id*.
[84] *Id*.
[85] *Id.* at 665.

Expenses for the administration of an estate ordinarily fall under section 67(e)(1) since they are not commonly or customarily incurred by a hypothetical individual holding the same property.[86] As a result, these expenses are not subject to the 2-percent floor and are disallowed by section 67(g). Examples of expenses of administration of an estate that are still deductible include "[p]robate court fees and costs; fiduciary bond premiums; legal publication costs of notices to creditors or heirs; the cost of certified copies of the decedent's death certificate; and costs related to fiduciary accounts."[87]

Previously, some administration expenses for nonbusiness related expenses were deductible in the same manner that they would be deductible if deducted by an individual.[88] A trust or estate may deduct these expenses so long as they are ordinary and necessary expenses for a trust or estate.[89] The expenses must be "(1) for the production or collection of income; (2) for the management, conservation, or maintenance of property held for the production of income; or (3) in connection with the determination, collection, or refund of any tax."[90] Formerly, "reasonable amounts paid or incurred by the fiduciary of an estate or trust on account of administration expenses…" were deductible unless the expenses were allocable to tax-exempt interest.[91] All of these expenses are now disallowed by section 67(g) since these items were deductible as miscellaneous itemized deductions. While nonbusiness related expenses are disallowed, business related expenses are still deductible because they are included in the computation of adjusted gross income and therefore not subject to the 2-percent floor.[92]

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[86] § 1.67-4(a).
[87] § 1.67-4(b)(6).
[88] § 212.
[89] Diane L. Mutolo, *2013 Emerging Issues 7017, Deduction of Investment Advisory Expenses for Estates & Trusts* (2013).
[90] Mutolo, *supra* note 89; § 212.
[91] Mutolo, *supra* note 89; Treas. Reg. § 1.212-1(i) (2018).
[92] I.R.C. §62(a)(4) (2018); §212

In some cases, it may be in an estate's best interest to take deductions that would be disallowed on an estate's income tax return since estate tax returns have differing rules on allowance for deductions. Since an estate tax return allows deductions for administration expenses of an estate that have not already been deducted on an income tax return for the estate, the few expenses that are disallowed for estate income tax return under section 67(g) may be deductible on an estate tax return.[93] To be deductible on the estate tax return, the expenses fall under section 2053, which is an above-the-line deduction. Under section 2053, estates are allowed a deduction from the gross estate for funeral expenses, administration expenses, claims against the estate, and mortgages or indebtedness on property included in the estate.[94]

e. Appraisal Fees

Generally, since appraisal fees incurred by a non-grantor trust or estate are not commonly or customarily incurred by a hypothetical individual holding the same property, these fees fall under section 67(e)(1) and are not subject to the 2-percent floor.[95] Fees not subject to the 2-percent floor include appraisal fees incurred to determine "the fair market value of assets as of the decedent's date of death (or the alternate valuation date), to determine value for purposes of making distributions, or as otherwise required to properly prepare the estate's or trust's tax returns, or a generation-skipping transfer tax return."[96]

Appraisal fees that would commonly or customarily be incurred by a hypothetical individual holding the same property include fees associated with an appraisal for insurance purposes.[97] The *Conference Report* also included "appraisal fees for a casualty loss or charitable

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[93] I.R.C. § 2053 (2018).
[94] *Id.*
[95] § 1.67-4(a), (b)(5).
[96] § 1.67-4(b)(5).
[97] § 1.67-4(a), (b)(5).

contribution" as appraisal fees subject to the 2-percent floor, disallowing them under section 67(g).[98]

f. Ownership Costs

Costs of ownership of property are generally considered commonly or customarily incurred by a hypothetical individual holding the same property since they are incurred no matter who owns the property.[99] As a result, deductions for ownership costs are subject to the 2-percent floor under section 67(a) and are now disallowed by section 67(g).[100] Examples of ownership costs include "partnership costs deemed to be passed through to and reportable by a partner if these costs are defined as miscellaneous itemized deductions pursuant to section 67(b), condominium fees, insurance premiums, maintenance and lawn services, and automobile registration and insurance costs."[101] Other ownership costs, "such as 62(a)(4) (rents and royalties), 162 (business expenses), or 164(a) (taxes)," are fully deductible under other provisions of the Code rather than under section 67.[102]

One way to deduct ownership costs associated with property that would be disallowed by section 67(g) is to characterize the property as rental property. Ordinarily, death neutralizes an asset's income tax characteristics.[103] As a result, when the estate holds property, it may choose a different characterization than the decedent's characterization of the property. Property held as personal residence by the decedent may be held as rental property by the estate so that the estate may take deductions associated with the management of the property. Since trusts and estates

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[98] H.R. REP. NO. 115-466, at 274.
[99] § 1.67-4(a).
[100] § 1.67-4(b)(2).
[101] § 1.67-4(b)(2).
[102] Cantrell, *supra* note 47, at 5.
[103] Ferguson, Freeland, and Ascher, *Federal Income Taxation of Estates, Trusts, and Beneficiaries*, §3.01 (2003).

include expenses attributable to rents and royalties in the computation of adjusted gross income, the expenses would be above-the-line deductions.[104]

While most ownership costs are no longer deductible on an estate or trust income tax return under section 67, "expenses necessarily incurred in preserving and distributing the estate, including the cost of storing or maintaining property of the estate if it is impossible to effect immediate distribution to the beneficiaries, are deductible" on an estate tax return.[105] As a result, for estates with estate taxes owed, these expenses may still be deductible.

g. Legal Expenses

Legal expenses in defense of a trust or estate would generally be deductible because they would not have been incurred had the property been held individually.[106] The litigation cannot be "incurred in defense of a claim against the estate, the decedent, or the non-grantor trust that are unrelated to the existence, validity, or administration of the estate or trust," such as a dispute that arose while the decedent was alive.[107] Some instances where courts have allowed a deduction for litigation expenses under section 67(e)(1) include "contesting an income tax deficiency" and "prosecuting a suit to have a residuary trust declared void with the trust property paid back into the estate."[108]

Litigation costs that arise out of a tax deficiency, however may not be deductible as a result of section 67(g). In *Trust of Bingham v. Commissioner*, the Supreme Court held that litigation expenses were deductible by a trust when a trustee contested a tax deficiency under

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[104] §62(a)(4) (2018); §212
[105] Diane L. Mutolo, *2014 Emerging Issues 7249, Final Regs on Itemized Deductions of Estates and Non-Grantor Trusts* (2014); Treas. Reg. § 20.2053-3(d)(1).
[106] § 1.67-4(b)(1).
[107] *Id.*
[108] Mutolo, *supra* note 105.

former section 23(a)(2), which later became section 212.[109] "Since there is no requirement that business expenses be for the production of income, there is no reason for that requirement in the case of like expenses of managing a trust, so long as they are in connection with the management of property which is held for the production of income."[110] The cost of litigation was a cost of management that was ordinarily and necessary incurred.[111] Since section 212 is deductible under section 67(a) when the expenses do not relate to a business, it is a miscellaneous itemized deduction and disallowed by section 67(g).

h. Bundling Fees

Before the *Tax Cuts and Jobs Act*, in its final regulations regarding deductions for trusts and estate, the Treasury made it clear that fees incurred in a trust or estate administration could no longer be "bundled" when taking a deduction.[112] Specifically, fees paid "for both costs that are subject to the 2-percent floor and costs (in more than a *de minimis* amount) that are not, …the single fee, commission, or other expense (bundled fee) must be allocated, for purposes of computing the adjusted gross income of the estate or non-grantor trust in compliance with section 67(e), between the costs that are subject to the 2-percent floor and those that are not."[113] For example, under the regulations, a trustee that also rendered investment advisory services to the trust would have to apportion his time between the two services provided.

As a result of Regulation § 1.67-4, fiduciaries, attorneys, and accountants who acted in more than one role in a trust or estate have already begun separating fees.[114] Specifically, fees

[109] Mutolo, *supra* note 89; *Tr. of Bingham v. Commissioner*, 325 U.S. 365 (1945).
[110] *Tr. of Bingham*, 325 U.S. at 374.
[111] *Id.* at 375.
[112] § 1.67-4(c).
[113] § 1.67-4(c)(1).
[114] § 1.67-4(c)(2); Cantrell, *supra* note 47, at 10.

computed at an hourly rate must be unbundled and apportioned to the appropriate type of fee.[115] Fees that are not computed at an hourly rate only need to be unbundled when the fees include investment advice.[116] "Any reasonable method may be used to allocate a bundled fee between those costs that are subject to the 2-percent floor and those costs that are not."[117] The examples included in the regulation are, determining "the percentage of the value of the corpus subject to investment advice, whether a third party advisor would have charged a comparable fee for similar advisory services, and the amount of the fiduciary's attention to the trust or estate that is devoted to investment advice as compared to dealings with beneficiaries and distribution decisions and other fiduciary functions."[118] The regulations allow for other methods beyond the three methods suggested.[119] Additionally, out-of-pocket expenses that would ordinarily be subject to the 2-percent floor must also be separated from the fee in order to deduct under section 67(e)(1).[120]

Since there is already guidance on how to unbundle fees to apportion them between sections 67(e)(1) and 67(a), with the addition of section 67(g), a fiduciary of a trust or estate will simply use the allocation to determine which fees are allowed. For the portion of the fees that the regulations subject to the 2-percent floor, a trust or estate would not be able to take a deduction while the portion of the fees that are not subject to the 2-percent floor would be deductible under section 67(e)(1). While the apportionment was only important when the miscellaneous itemized deductions were less than the 2-percent floor before the *Tax Cuts and Jobs Acts,* now the

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[115] *Id.*
[116] *Id.*
[117] § 1.67-4(c)(4).
[118] § 1.67-4(c)(3).
[119] *Id.*
[120] *Id.*

allocation will be extremely important. Like fees attributable to tax-exempt interest, the allocation of fees will determine whether or not the deduction is allowed.

i. Final Allowance of Miscellaneous Itemized Deductions

In the year of termination, trusts and estates may pass excess deductions to their beneficiaries.[121] The beneficiary may not use the deduction in computing adjusted gross income.[122] Instead, the excess deductions passed to the beneficiary as an itemized deduction. Since the deduction "loses any special flavor it may have had in the hands of the entity,"[123] the deduction is a miscellaneous itemized deduction, now disallowed by section 67(g).

Since section 67(g) takes effect on January 1, 2018, "if a trust or estate is going to make a final distribution in the first 65 days of 2018," and if the total deductions subject to the 2-percent floor in 2017 exceeded the 2-percent floor, it would have been in a trust or estate's best interest "to make a '[s]ection 663(b) election' to treat the distribution as occurring on the last day of 2017. Any deductions in excess of income would pass to the beneficiaries, thereby enabling them to deduct the expenses on their 2017 individual income tax returns, subject to the 2% floor."[124] Further, the deductions may not be carried forward so that they may be taken after section 67(g) sunsets.[125] If the election was not made during the first 65 days of this year by the entity, the excess deductions on termination would be lost. During years where section 67(g) is in effect, fiduciaries should minimize the excess deductions that are passed to beneficiaries in the year of termination so that they are not lost.

[121] I.R.C. § 642(h) (2018).
[122] Treas. Reg. § 1.642(h)-2(a) (2018).
[123] Ferguson, Freeland, and Ascher, *Federal Income Taxation of Estates, Trusts, and Beneficiaries*, §12.03[D] (2003).
[124] Jeffery Eisen et al., *How Does the Suspension of Miscellaneous Itemized Deductions Impact Your Trust or Estate?* (last visited May 16, 2018, 3:41 PM), https://blogmsk.com/2018/01/25/how-does-the-suspension-of-miscellaneous-itemized-deductions-impact-your-trust-or-estate/.
[125] § 1.642(h)-2(a).

While beneficiaries will not be able to deduct excess deductions in the year of a trust or estate termination while section 67(g) is in effect, beneficiaries are still able to take any unused net operating loss carryovers and capital loss carryovers since such losses retain their character when passed to beneficiaries.[126]

IV. Deductions Available Under Section 67(e)(2)

Section 67(e)(2) provides that "the deductions allowable under sections 642(b), 651, and 661" may be taken as above-the-line deductions when computing the adjusted gross income of an estate or trust.[127] Section 67(e)(2) is still in effect after the *Tax Cuts and Jobs Act* since it is an above-the-line deduction not subject to the 2-percent floor.[128]

Section 67(e)(2) allows a personal exemption deduction under section 642(b) when computing adjusted gross income of an estate or trust.[129] section 642(b) allows an estate a deduction of $600 and a trust a deduction of either $100 or $300 if the income is required to be distributed currently.[130] While the personal exemption is suspended for individuals under section 11041 of the *Tax Cuts and Jobs Act*, which provides that the exemption amount is zero under section 151(d)(5)(A), section 151(d)(5)(B) clarifies that "[f]or purposes of any other provision of this title, the reduction of the exemption amount to zero under subparagraph (A) shall not be taken into account in determining whether a deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction, under this section."[131] As a result, the change in the personal exemption allowed for individuals does not affect any other section on personal exemptions,

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[126] § 1.642(h)-1(b).
[127] § 67(e)(2).
[128] *Id.*
[129] *Id.*
[130] I.R.C. § 642(b) (2018).
[131] *Tax Cuts and Jobs Act* at 29.

including section 642.[132] Because section 642(b) is not effected by section 151, the personal exemption amounts provided under section 642(b) are still deductible for trusts and estates under section 67(e)(2).

Section 67(e)(2) also provides a deduction for trusts distributing income currently under section 651.[133] Under section 651, trusts may deduct "the amount of the income for the taxable year which is required to be distributed currently" when computing the taxable income of the trust.[134] Similarly, section 67(e)(2) provides a deduction for trusts and estates accumulating income under section 661 for "any amount of income for such taxable year required to be distributed currently" and "any other amounts properly paid or credited or required to be distributed for such taxable year" limited to the distributable net income of the trust or estate.[135] Since these distribution deductions are fully deductible, above-the-line deductions, they are not miscellaneous itemized deductions subject to section 67(g).[136]

V. Conclusion

While the status of trust and estate deductions is unclear after the *Tax Cuts and Jobs Act* added section 67(g) to section 67, the best practice until Congress or the Treasury issues guidance will be to separate fees and expenses and deduct items that fall under sections 67(b), 67(e)(1), and 67(e)(2) the same way they would have been deducted before the *Tax Cuts and Jobs Act*. Since the Treasury has developed a list of fees and expenses commonly incurred by a trust or estate, fiduciaries may use the list to determine whether a fee or expense is deductible under section 67(e)(1) or disallowed as subject to the 2-percent floor.[137] Additionally, since the

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[132] I.R.C. § 642(b) (2018); *Tax Cuts and Jobs Act* at 29.
[133] § 67(e)(2).
[134] I.R.C. § 651(2018).
[135] § 67(e)(2); I.R.C. § 661 (2018).
[136] Akers, *supra* note 24, at 9.
[137] § 1.67-4(b).

Treasury developed the rules on section 67(e)(1) deductions several years prior to the *Tax Cuts and Jobs Act*, fiduciaries, attorneys, and accountants should have already been apportioning their fees between a deduction under section 67(e)(1) and a deduction subject to the 2-percent floor, making the determination of deductibility simple under section 67(g).

As fiduciaries come to better understand the implications of section 67(g), they may be able to use the unbundling of fees in any reasonable manner to their advantage so that they select a reasonable manner that results in more fees being deductible under section 67(e)(1). Since fiduciaries may choose to unbundle the fees by determining the percentage of the value of the corpus attributable to the fees, apportioning based on what a third-party advisor would charge, determining the amount of the fiduciary's attention was attributed to investment advice, or using any other reasonable method, the fiduciary could select the method that results in the smallest portion of the fees allocated to the investment advice rendered.[138] Further, since the regulations do not require the fiduciary to remain consistent with the method they choose, during the period in which section 67(g) remains in effect, a fiduciary could switch methods each year to apportion the fees in a way that would best suit the trust or estate.[139]

While section 67(g) will cause a disallowance of deductions for certain types of itemized deductions for trusts and estates, section 67(g) should not be overly burdensome to decipher since the methods are already in place for determining how deductions are allowed and since section 67(g) will only affect a small portion of deductions under section 67(e).

[138] § 1.67-4(c)(3).
[139] § 1.67-4(c).