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Issue Contents

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Administrative Expenses of Estates and Trusts: Still Deductible After TCJA 2017?

by Robert P. Achenbach, Jr.*

The Tax Cuts and Jobs Act of 2017 suspended the miscellaneous itemized deductions for tax years beginning after December 31, 2017, and before January 1, 2026.[1] This raised the issue as to whether this suspension also applied to estates and non-grantor trusts, although the new law makes no mention of any exceptions.[2]

Pre-2018 Law - Individuals

In general, in the case of an individual, the miscellaneous itemized deductions for any taxable year were allowed only to the extent that the aggregate of such deductions exceeded 2 percent of adjusted gross income.[3] The term "miscellaneous itemized deductions" means the itemized deductions other than those listed in I.R.C. §§ 67(b)(1) through (12).

Pre-2018 Law - Estates and Non-Grantor Trusts

The adjusted gross income of an estate or trust is computed in the same manner as that of an individual, except (1) the deductions for costs which are paid or incurred in connection with the administration of the estate or non-grantor trust[4] and which would not have been incurred if the property were not held in such estate or trust, and (2) the deductions allowable under I.R.C. §§ 642(b), 651, and 661 which are allowable in arriving at adjusted gross income (above the line).[5]

Stated another way, under regulations adopted in 2014, an estate or non-grantor trust administrative cost deduction 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.[6]

The regulations also provide that, in analyzing a cost to determine whether it commonly or customarily would be incurred by a hypothetical individual owning the same property, it is the type of product or service rendered to the estate or non-grantor trust in exchange for the cost, rather than the description of the cost of that product or service, that is determinative.[7] The regulations provide specific examples of costs that will be considered commonly or customarily incurred by individuals and those that will not.[8]

Finally, the regulations provide that, subject to certain exceptions, if an estate or non-grantor trust pays a single fee, commission, or other expense for both costs that are subject to the 2-percent floor and costs (in a more than *de minimis* amount) that are not, then, except to the extent provided otherwise by guidance published in the Internal Revenue

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Bulletin, the single fee, commission, or other expense (so-called 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.[9]

Effect of TCJA 2017 on Deductibility of Administrative Costs

Because the 2017 Act makes no distinction as to the taxpayers affected by the suspension of miscellaneous deductions, taxpayers and practitioners were justified in being concerned that estates and non-grantor trusts could also be denied a deduction for all miscellaneous itemized deductions, whether or not they are subject to the 2 percent limitation under the pre-2018 Code and regulations.

Notice 2018-61

The IRS has issued *Notice 2018-61*[10] to announce that it intends to issue regulations clarifying that estates and non-grantor trusts may continue to deduct (1) costs which are paid or incurred in connection with the administration of the estate or non-grantor trust and which would not have been incurred if the property were not held in such estate or trust and (2) amounts allowable as deductions under I.R.C. §§ 642(b), 651 or 661, including the appropriate portion of a bundled fee, in determining the estate or non-grantor trust's adjusted gross income during taxable years for which the miscellaneous itemized deductions would otherwise be suspended by the 2017 Act.

However, the deduction for costs paid or incurred in connection with the administration of the estate or non-grantor trust which were subject to the 2 percent floor for miscellaneous deductions prior to 2018 would be suspended by the 2017 Act.

Effect of TCJA 2017 on Deductibility of Excess Deductions

On the termination of an estate or trust which has: (1) a net operating loss carryover under I.R.C. § 172 or a capital loss carryover under I.R.C. § 1212, or (2) for the last taxable year of the estate or trust, deductions (other than the personal exemption or charitable contributions) in excess of gross income for such year, then such carryover or such excess is allowed as a deduction to the beneficiaries succeeding to the property of the estate or trust.[11] An excess estate or trust deduction is not used in computing the beneficiaries' adjusted gross income and is treated as a miscellaneous itemized deduction of the beneficiaries.[12]

Prior to the TCJA 2017 suspension of miscellaneous itemized deductions, such deductions were allowed, subject to the restrictions described above. The IRS states that, for the years in which miscellaneous itemized deductions are not permitted under TCJA 2017, it appears also to exclude the excess deductions on termination of an estate or trust. The Treasury Department and the IRS are studying whether deductions that would not be subject to the limitations imposed by Sections 67(a) and (g) in the hands of the trust or estate should continue to be treated as miscellaneous itemized deductions when they are included as an excess deduction in the hands of beneficiaries. *Notice 2018-61* states that regulations on this issue are forthcoming but does not identify any potential IRS interpretation of the TCJA 2017 provision for this purpose.

ENDNOTES

[1] Pub. L. No 115-97, § 11045, 131 Stat. 2088 (2017), *amending* I.R.C. § 67.

[2] See Harl, *Agricultural Law*, § 44.01[3] (2018) for discussion of estate tax deductions for administrative costs and Harl, *Farm Income Tax Manual*, § 3.25[4] (2018) for discussion of miscellaneous itemized deductions.

[3] I.R.C. § 67(a), prior to suspension by TCJA 2017.

[4] See Temp. Treas. Reg. §1.67-2T(g)(1)(i).

[5] I.R.C. § 67(e).

[6] Treas. Reg. § 1.67-4(a).

[7] Treas. Reg. § 1.67-4(b).

[8] *Id*.

[9] Treas. Reg. § 1.67-4(c).

[10] 2018-31 I.R.B. 278.

[11] I.R.C. § 642(h). See Harl, *Agricultural Law*, § 44.11 (2018) for discussion of excess losses and deductions of estates and trusts.

[12] Note that Treas. Reg. § 1.642(h)-1(b) provides that net operating loss carryovers and capital loss carryovers are taken into account when determining adjusted gross income. Therefore, they are above-the-line deductions and thus are not miscellaneous itemized deductions on the returns of beneficiaries.

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

GENERAL

EXEMPTIONS

HOMESTEAD. The debtors, husband and wife, owned an 88 acre tract of rural land in Texas and had the two acres with the house and buildings designated as the exempt homestead for Texas property tax assessment purposes. The debtors used the property for raising goats, cows, and horses; for hunting and fishing; for running a catering business; and for carrying on general family activities. The debtors claimed the entire 88 acres as exempt homestead property under *Tex. Const. Art. 16, § 51* which states that "[t]he homestead, not in a town or city, s hall consist of not more than two hundred acres of land, which may be in one or more parcels, with the improvements thereon." See also *Tex. Prop. Code § 41.002(b)(1)*. A creditor challenged the scope of the exemption, arguing that the designation of only two acres as the homestead for