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Tax Reform Effect on Taxation of Trusts and Estates

The Tax Cuts and Jobs Act of 2017 is intended to cut taxes for individuals and corporations in part by reducing the tax rates and increasing the standard deduction (while limiting many itemized deductions). However, little was included in the Act that benefits taxation of trusts. Tax rates for trusts had a minimal change, and the standard exemption for trusts remained unchanged; however, they still are impacted by the limitations of itemized deductions. Specifically, **miscellaneous itemized deductions** subject to the 2% limit that are no longer deductible for an individual are now **no longer deductible** by a trust, either. This includes investment advisory fees, gift tax prep fees, and property ownership costs that are not a part of a trade or business.

What is Deductible?

Notice 2018-61, Clarification Concerning the Effect of Section 67(g) on Trusts and Estates, was released in July 2018 and provides a little good news for trusts. This notice clarifies that trust expenses falling under Section 67(e) are **still deductible on a trust**. These expenses are expenses that would **not commonly be incurred by individuals**, which include fiduciary fees, fiduciary tax prep fees, estate tax prep fees, a decedent's final income tax return prep fees, and legal fees associated with administering a trust.

Bundled Fiduciary Fees

One issue that could arise from these new tax laws is the allocation of bundled deductible fiduciary fees and nondeductible investment advisory fees. If an institution acts as both the fiduciary and investment advisor, they will need to separately state their fees for tax preparation.

Trust Income Does Not Equal Taxable Income

Another issue that could arise from these new tax laws is the discrepancy between fiduciary accounting income and taxable income, particularly in a simple trust. A simple trust with high investment advisory fees will now have a fiduciary accounting deduction but not a taxable deduction. This results in taxable income higher than fiduciary accounting income, which then cannot be distributed out of the trust, and the extra taxable income is now taxed at the high trust tax rates.

Other Changes

Estates and trusts are allowed the Section 199A, 20-percent deduction for qualified business income. Please refer to our Section 199A guidance on information regarding this deduction. Notice 2018-61 also included information regarding excess deductions passed out to a beneficiary on the trust or estate's final K-1. Currently these expenses, even the expenses included in Section 67(e), are considered miscellaneous itemized deductions for an individual, which are no longer deductible with the new tax law. The notice stated that the IRS intends to issue more regulations in this area on whether or not these deductions should be separated from other miscellaneous expenses and still be deductible.