

Treasury Decision 9664, May 9, 2014 re: IRC Sec. 67 and the 2% Rule

On May 9, 2014 the Treasury Department and the IRS adopted final regulations, which generally retained the 2011 proposed regulations with minor modifications. The final regulations are effective for tax years beginning **on or after May 9, 2014** and address several types of expenses. The net effect is that many more expenses will now be classified as subject to the 2% rule, as you will see below. The following is a summary of the new rules, and a copy of the Treasury Regs. may be found on the TEdec home page under Free Resources. Our comments will be keyed to sections of the Regulations:

IRS Reg. § 1.67-4 Costs Paid or Incurred by Estates or Non-Grantor Trust (a). In General: § 67(e) provides an exception to the 2% floor for miscellaneous itemized deductions for costs that are paid or incurred in connection with the administration of an estate or a trust that would not have been incurred if the property were not held in such estate or trust. The cost is subject to the 2% floor to the extent that: 1) it is incurred in the definition of miscellaneous itemized deductions under § 67(b); 2) is incurred by an estate or non-grantor trust; and 3) commonly or customarily would be incurred by a hypothetical individual holding the same property.

(b) Commonly or Customarily Incurred is a Critical Term. (1) In General: In analyzing the 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 that is determinative. The types of costs described as "commonly or customarily incurred by an individual" are described in sub paragraphs (b)(2 thru 6) of this section of the regulations [also listed below], and also include such expenses as defense of a claim against an estate, the decedent or a non-grantor trust that are unrelated to the existence, validity or administration of the estate or trust. Below is a reference to the specific type of costs that are commonly or customarily incurred by an individual:

(2) Ownership Costs: Ownership costs are costs incurred simply by being an owner, and would include such expenses as: partnership costs deemed to be passed through to or reportable by the partner, if the cost were defined as miscellaneous itemized deductions; condominium fees, insurance premium, maintenance and lawn service, automobile registration and insurance costs.

(3) Tax Preparation Fees: Costs relating to the preparation of the 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% floor. The cost of preparing all other tax returns are subject to the 2% floor.

(4) Investment Advisory Fees: Fees for investment advice are incurred commonly and customarily by a hypothetical individual investor and therefore are subject to the 2% floor. However, there may be some incremental fees for investment advice above and beyond the amount that normally would be charged to an individual investor, which are not subject to the 2% floor (such as special additional charges that are added solely because the investment advice is rendered to a trust or an estate rather than to an individual, or attributed to an unusual investment objective or the need for specialized balancing of interest - but this is a limited exception).

(5) Certain Fiduciary Expenses. Certain fiduciary expenses, which are not commonly or customarily incurred by individuals, are not subject to the 2% of AGI Floor Rule (Treas. Reg. §1.67(b)6). Such expenses include, without limitation: probate 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.

(6) Appraisal Fees. Certain appraisal fees will not be subject to the 2% rule (Treas. Reg. § 1.67(b)5). Appraisal fees incurred by an estate or a non-grantor trust to determine the fair market value of assets as of the date of the decedent's death (or alternate valuation date) or to determine the value for purposes of making distributions or as otherwise required to properly prepare the estate or trust tax returns, or a generation skipping transfer tax return, are not incurred commonly or customarily by an individual and thus are not subject to the 2% rule. Other appraisal costs, however, for other purposes (eg. insurance) are commonly and customarily incurred by individuals and therefore will be subject to the 2% floor.

(c) Bundle Fees: Where an estate or non-grantor trust pays a single fee, commission or other expense (such as a fiduciary's commissions, attorney's fee or accountant's fee) for both costs that are subject to the 2% floor and costs that are not, then the same must be allocated in some reasonable fashion and the regulations provide a number of requirements in that connection.