

Certain Trust Expenses Still Deductible Until 2026

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The Tax Cuts and Jobs Act (TCJA), while lowering taxes for most, raised them for a few. One group of those few taxpayers for whom taxes went up under TCJA were certain trusts and estates (generally those with large investment advisory fees or certain other expenses). The issue for these trusts is that the TCJA cut out miscellaneous itemized deductions for everyone, but trusts have no standard deduction to fall back on like individual taxpayers do. Lower deductions equal higher taxable income, and the tax brackets and rates applicable to trusts (while slightly trimmed under the TCJA) are not on the whole largely different than the pre-TCJA tax brackets and rates were. Not all is lost, however. The IRS recently finalized regulations providing guidance on which expenses a trust can still deduct, and importantly, for those that advise trustees or beneficiaries, when those advisory fees are still deductible.

Let's quickly review the basics. Most advisory, tax preparation, and similar fees are categorized as miscellaneous itemized deductions. Pre-TCJA, for an individual, these fees were deductible to the extent they exceeded 2% of adjusted gross income. Trusts have this same rule, but get a special break in the case of costs which are paid or incurred in connection with the administration of the trust that would not have been incurred if the trust property was instead held by an individual. Even better, these costs don't have a 2% floor and are completely deductible from the first dollar. So, when is a cost in the first category (non-deductible for individuals under TCJA, and for trusts as well), and when is a cost in the second category (still fully deductible for trusts)?

Under the final regulations, the following are considered costs in the first category:

- Costs where the existence and nature of the cost would still be incurred if an individual were holding the same property. The regulations give as an example the cost incurred in defense of a claim against an estate or decedent, where such claim is unrelated to the existence validity or administration of the decedent's trust.
- Ownership costs such as condominium fees, insurance premiums, maintenance and lawn services, and automobile registration and insurance costs. The regulations also give as an example any costs that are passed through to the trust (such as where the trust is a partner in a partnership), where such costs would be defined as miscellaneous itemized deductions if passed through to an individual.
- Fees for investment advice, including fees for any related services that would be provided to an individual investor, where those fees are those that would be commonly or customarily incurred by an individual investor.

The following are costs that are considered to fall into the second category:

- Tax preparation fees: Costs relating to all estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax return (probably because individuals can never prepare their own final individual income tax returns). The costs of preparing all other tax returns (for example, gift tax returns) are excepted out and placed back into the first category.
- There is a special exception for "certain incremental costs of investment advice beyond the amount that would normally be charged to individual investor." An incremental cost is defined as "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."
- Appraisal fees to determine the fair market value of assets as of the decedent's date of death, to determine value for the purposes of making distributions, or as otherwise required to properly prepare the trust's tax returns. Appraisals for insurance purposes are excepted out and placed back in the first category.
- Certain fiduciary expenses not commonly incurred by individuals, such as 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.

So, trustees need to make sure that they keep careful records when paying the trust's expenses, and include enough information regarding what an expense was paid for. That way, the trust's tax professionals can determine which category the expense falls into. Advisors to trustees and/or beneficiaries (whether CPAs, attorneys, or other professionals) should be sure to alert the trustee (or beneficiaries) when their fees are or are not deductible to the trust. Lastly, investment advisors who render special advice to trustees regarding investments should take care to separately invoice such amounts, as such amounts may be deductible by the trust.

While the TCJA has in some cases increased taxes for trusts, the final regulations have provided important clarification, and remind trustees and others that there are still some expenses deductible by trusts.