O’Neill v. Commissioner, 98 T. C. 227, 1992 U. S. Tax Ct. LEXIS 21, 98 T. C. No. 17 (1992)

Investment advice fees paid by a trust are subject to the 2% floor on miscellaneous itemized deductions unless they are unique to trust administration.

Summary

In O’Neill v. Commissioner, the U. S. Tax Court addressed whether investment advice fees paid by a trust were fully deductible or subject to the 2% adjusted gross income limitation. The trust, formed in 1965, hired an investment advisor in 1979. The court held that these fees were not unique to trust administration and thus subject to the 2% floor, emphasizing that only costs unique to trusts or estates qualify for full deduction under IRC section 67(e).

Facts

The William J. O’Neill, Jr. , Irrevocable Trust was established in 1965. In 1979, an investment advisory agreement was signed with Allen & Leavy Investment Management, Inc. , which later merged into Wall, Patterson, Hamilton & Allen. In 1987, the trust paid $15,374 in investment advice fees, which were deducted in full on its tax return. None of the trustees had investment expertise, and they required an investment advisor to manage the trust’s over $4. 5 million in assets.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the trust’s 1987 tax return, asserting that the investment advice fees were subject to the 2% limitation under IRC section 67(a). The case was submitted to the U. S. Tax Court, where it was assigned to a Special Trial Judge before being adopted by the full court.

Issue(s)

1. Whether investment advice fees paid by a trust are fully deductible under IRC section 67(e) as costs incurred in connection with trust administration that would not have been incurred if the property were not held in trust.

Holding

1. No, because investment advice fees are not unique to the administration of a trust and are commonly incurred by individual investors, thus falling under the 2% floor of IRC section 67(a).

Court’s Reasoning

The court interpreted IRC section 67(e) to apply only to costs unique to trust or estate administration. It distinguished between general investment advice fees, which individuals also incur, and costs specific to trusts, like trustee fees or mandatory accounting fees. The court rejected the trust's argument that Ohio law necessitated the hiring of an investment advisor, noting that the state's statutes provided a list of permissible investments that could be made without such advice. The court emphasized that the decision to hire an investment advisor was not mandated by law but was a choice of the trustees, thus not qualifying for full deduction under section 67(e).

Practical Implications

This decision clarifies that trusts cannot fully deduct investment advice fees unless they can prove these fees are unique to trust administration. Practitioners must carefully distinguish between general investment costs and those uniquely tied to trust management. This ruling may influence how trusts structure their investment management agreements and how they report such expenses on tax returns. Subsequent cases have followed this precedent, reinforcing the narrow interpretation of section 67(e) and impacting trust tax planning strategies.