

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **AM 2007-0010**

Release Date: 5/25/07

CC:ITA:B04:SSPflanz
POSTN-128932-06

UILC: 67.04-00

date: June 30, 2006

to: Janice B. Geier
Special Counsel
(Small Business/Self-Employed)

from: Robert M. Brown
Associate Chief Counsel
(Income Tax & Accounting)

subject: Generic Chief Counsel Advice -Deductibility of Administrative Expenses of
Bankruptcy

This Chief Counsel Advice responds to your request for our advice on whether § 67(e) of the Internal Revenue Code applies to the administrative expenses of an individual debtor's estate in bankruptcy. In accordance with § 6110(k)(3), this advice may not be used or cited as precedent.

ISSUE

Whether § 67(e) of the Internal Revenue Code applies to the administrative expenses of an individual debtor's estate in bankruptcy.

CONCLUSION

Section 67(e) applies to an individual debtor's estate in bankruptcy. Therefore, deductions for expenses paid or incurred in connection with the administration of an individual's estate in bankruptcy that would have not been incurred if the property were

not held by the bankrupt estate is treated as allowable in arriving at adjusted gross income.

LAW AND ANALYSIS

Subchapter B

Section 67(a) provides that for an individual taxpayer miscellaneous itemized deductions are allowed only to the extent that the aggregate of such deductions exceeds 2 percent of adjusted gross income. Section 67(b) lists the itemized deductions that are not miscellaneous itemized deductions and thus not subject to the 2 percent floor.

Section 67(e) provides that the adjusted gross income of an estate or trust shall be computed in the same manner as in the case of an individual. However, § 67(e)(1) provides that the deductions for costs paid or incurred in connection with the administration of an estate or trust that would not have been incurred if the property were not held in such trust or estate shall be treated as allowable in arriving at adjusted gross income.

In addition, § 67(e)(2) provides that deductions allowable under §§ 642(b), 651, and 661, shall be treated as allowable in arriving at adjusted gross income. The final sentence of § 67(e) states that under regulations, appropriate adjustments shall be made in the application of part I of subchapter J of this chapter to take into account the provisions of this section.¹

Subchapter V

Section 1398 describes the treatment of an individual debtor's estate in bankruptcy. Section 1398(c)(1) provides the general rule that the taxable income of the estate is computed in the same manner as for an individual. Section 1398(e)(3) states that, except as otherwise provided in this section, the determination of whether any amount paid or incurred by the estate is allowable as a deduction shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trade or businesses, and in the activities, the debtor was engaged in before the commencement of the case.

¹ Section 67(e) was amended in 1988 to add the treatment, for purposes of § 67, of deductions under §§ 651 and 661 (relating to certain amounts distributed by a trust or estate). See H.R. Rep. No. 795, 100th Cong., 2d Sess. 10 (1988). *In re Miller*, discussed below, concluded that the exception in § 67(e) applied to a subchapter V bankruptcy estate, as well as other estates governed by subchapter J. The bankruptcy court noted that the 1988 amendment to § 67(e), which added the reference to Subchapter J, did not alter the text acknowledging the "above-the-line" deduction. 252 B.R. at 115.

Section 1398(h)(1) provides, in part, that any administrative expense allowed under section 503 of the Bankruptcy Code, 11 U.S.C. § 503, is allowed as a deduction to the extent not disallowed by another provision of the Internal Revenue Code.

In re Miller

In re Miller, 252 B.R. 110 (Bankr. E.D. Tex. 2000), addressed the deductibility of administrative expenses by an individual's estate in bankruptcy. On its return the estate deducted the expenses from gross income in arriving at adjusted gross income. In its post-hearing brief the IRS contended that § 67(e) was inapplicable to an estate in bankruptcy, that deductibility of the expenses was limited to the amounts that the debtor could have deducted under § 1398(e)(3), and that the expenses could be deducted only as miscellaneous itemized deductions. The court rejected this position, concluding that § 67(e) was applicable and that § 1398(h)(1) was an exception to the general rule that a bankruptcy estate is only entitled to a deduction if the debtor would have been able to take such a deduction. A deduction was allowed for the expenses in arriving at adjusted gross income.

Discussion

We agree with the bankruptcy court's conclusion in *In re Miller*, that a bankruptcy estate is a "trust or estate" within the meaning of 67(e). We believe that the exception in § 67(e) applies to subchapter V bankruptcy estates, as well as other estates governed by subchapter J. Therefore, applying § 67(e) to a debtor's estate in bankruptcy, the deduction for expenses paid or incurred in connection with administration of an estate in bankruptcy that would not have been incurred had the property not been held in such estate is treated as allowable in arriving at adjusted gross income.

Publication 908

Internal Revenue Service Publication 908, Bankruptcy Tax Guide (1996), at page 4, states that "the bankruptcy estate is allowed a deduction for administrative expenses and any fees or charges assessed it. These expenses are generally deductible as itemized deductions subject to the 2% floor on miscellaneous itemized deductions. However, administrative expenses attributable to the conduct of a trade or business by the bankruptcy estate or the production of the state's rents or royalties are deductible in arriving at adjusted gross income." We recommend revising Publication 908 to reflect the conclusion of *In re Miller*, that deductions for expenses that would not have been incurred if the property were not held by the bankrupt estate are allowable in arriving at adjusted gross income.