

The Still Present Above-the-Line Deduction for Legal Fees

To the Editor:

I am delighted to see that my colleague Professor Gregg Polsky so ably shouts down the argument that the above-the-line deduction for legal fees was thrown out with the bathwater of miscellaneous itemized deductions (“Miscellaneous Itemized Deductions And Litigation Expenses,” *Tax Notes*, Aug. 27, 2018, p. 1281). I am writing tax opinions to plaintiffs that the deduction remains in place, so I hope and believe Professor Polsky is right. Still, I have had disagreements with prominent tax advisers and law firms, who claim the deduction is gone.

My intent in flagging the concern (Robert W. Wood, “Legal Settlements With Tax Indemnities Are on the Rise,” *Tax Notes*, July 30, 2018, p. 687) was to be transparent, and to give a nod to conspiracy theorists who are fervently saying the deduction was deleted. Some are selling products or solutions to the problem (if it exists). Informally, some at the IRS have said they are not worried about the issue and that they don’t believe the deduction is gone. I’m with them.

However, to repeat a few of the arguments I hear coming from the grassy knoll, the deduction-is-gone folks might respond to Professor Polsky along the following lines: Section 62 does not itself create deductions, they say. Instead, it identifies what *otherwise* allowable deductions can be deducted *above-the-line*. Therefore, they say, if section 212 deductions are not allowed until 2026, any deduction under section 62(a)(20) that would otherwise be a section 212 deduction would also be disallowed.

But that argument incorrectly conflates section 212 deductions with miscellaneous itemized deductions. The new section 67(g) does not provide that section 212 deductions are disallowed until 2026. It provides that *miscellaneous itemized deductions* are disallowed until 2026. Not all section 212 deductions are miscellaneous itemized deductions.

As Professor Polsky notes, section 67(b) defines miscellaneous itemized deductions, which are a subset of itemized deductions. Section 63(d) says an itemized deduction is any deduction allowable under Chapter A, other than, *inter alia*,

an *above-the-line* deduction under section 62. Not all section 212 deductions are equal. Some are above-the-line deductions as a result of section 62(a). Others are below-the-line deductions because they don’t qualify for above-the-line treatment.

I read the disallowance of miscellaneous itemized deductions as affecting only *below-the-line* section 212 deductions. A deduction under section 212 is not a miscellaneous itemized deduction if it qualifies for above-the-line treatment under section 62. Consequently, I agree with Professor Polsky that a section 212 deduction (or a deduction under any other code section) qualifying for above-the-line treatment under section 62 should not be hurt by the disallowance of miscellaneous itemized deductions in section 67(g).

To return to the grassy knoll, I don’t wish to inflame this debate; I come to bury it. I expect the scores of plaintiffs who do not qualify for the (still present) above-the-line deduction are the real ones who should be screaming. Some of them may wake up to this issue only around tax time next year. If you are paying tax on 100 percent of a settlement when your lawyer keeps 40 percent, the fact that you get a \$24,000 standard deduction isn’t going to look so good.

Sincerely,

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