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Six Tax-Wise Ways To Reduce Your Legal Bills



No one likes paying legal fees, but tax rules can [reduce](#) your legal bills. Here's how.

1. You Can't Deduct Personal Legal Fees.

The least desirable legal expenses are those of a purely personal nature. Examples include divorce or if a family member sues you for slander. But some legal matters of a personal nature can impact business or investment, making some deductible. See [Stars and Their Legal Fees: Another Red Carpet?](#)

2. Legal Fees for Tax Advice Are Deductible.

Legal fees for tax advice are deductible, whether tax planning or controversies. Any tax qualifies, income, estate, gift, property, sales, use and excise tax, even if the taxes are personal.

3. Business Legal Fees Are Deductible.

Legal fees incurred in a trade or business are deductible by corporations, LLCs, partnerships and proprietorships. However, some fees must be

capitalized and added to the basis of assets. If you are trying to sell your business and spend \$50,000 in legal fees, can you deduct it against other income, or must you add it to your basis in your company? Usually the latter.

4. Investment Legal Fees Are Miscellaneous Itemized Deductions.

If legal expenses don't relate to your business but only to investments, you can still deduct them but usually only as a miscellaneous itemized deduction. That means a 2% threshold, phase-outs and (worst of all) Alternative Minimum Tax ([AMT](#)). See [AMT Problems For Attorney Fees Remain](#). However, as with business legal fees, some investment legal fees must be capitalized to the basis of the assets (such as legal fees for the purchase of investment property).

5. Beware Contingent Lawyer's Fees.

If you recover \$1 million in a lawsuit and owe 40% to your contingent fee lawyer, you might assume you have \$600,000 of income. How could you ***possibly*** have to pay tax on the full \$1 million? Answer: In [Commissioner v. Banks](#), the U.S. Supreme Court ruled you've got income when your lawyer is paid. That means you need to worry about how to deduct the fees.

In a pure personal physical injury case (say an auto accident or slip-and-fall), the entire recovery is tax-free so it doesn't matter whether you consider the recovery including legal fees or the net. Unfortunately, there is often confusion about what is and is not tax-free.

6. Legal Fees in Employment Cases Are Fully Deductible.

Most employment lawsuit recoveries are either wages (on a Form [W-2](#)) or non-wage income (on a Form [1099](#)). If your lawyer receives 40%, you still must include 100% in your income. However, you can deduct the legal fees "above-the-line," before reaching adjusted gross income. That means you have no tax—no regular tax and no AMT—on the legal fees. See [More on Attorney Fees Post-Banks](#).

Conclusion

Tax deductions can alleviate some of the pain of high legal bills. The tax analysis can be sophisticated, and you may incur legal fees falling into more than one category. There are often several ways of allocating fees, so planning can pay off.

For more, see:

[The Only Good Legal Fees Are Tax Deductible Legal Fees](#)

[Can Tax Rules Cut Legal Bills?](#)

[Deduct This: History of the Tax Attorney's Fees Deduction](#)

[Attorney Fee Deduction Problems Remain](#)

[Top 10 Tax Mistakes Made by Contingent Fee Lawyers](#)

[Attorney Fees: To Deduct or Not to Deduct](#)

[Big Legal Fee Tax Trap](#)

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