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Six Tips To Cut Your Legal Bills

No one likes paying legal fees, but you can [reduce](#) your legal bills if you're careful and observe these six tax rules:

1. You Can't Deduct Personal Legal Bills. Personal means nondeductible, so 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. Fees for Tax Advice Are Deductible. These are always deductible, whether for tax planning or disputes. Any tax qualifies, including income, estate, gift, property, sales, use and excise tax. Plus, despite the general rule on personal legal fees, tax fees are deductible even if the taxes are purely personal.

3. Business Legal Fees Are Deductible. Legal fees in a trade or business are deductible. However, some fees must be capitalized and added to the basis of assets. For example, say you are trying to sell your business and spend \$50,000 in legal fees. Can you deduct it against your 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. Contingent Lawyer's Fees Are Tricky. 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 tax-free.

6. Legal Fees in Employment Cases Are Fully Deductible. Most employment settlements are either wages (on a Form [W-2](#)) or non-wage income (on a Form [1099](#)). If your lawyer takes 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](#).

Bottom Line? Tax deductions alleviate some of the pain of legal bills. There are often several ways of allocating fees, so planning pays off.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.