

THE OTHER SIDE OF LEGAL FEES

Since we frequently cover the tax treatment of attorneys' fees ---and the specific problem of the plaintiff in the contingent fee legal case (such as an employment action)-- let's look at the other side of legal fees. There's no problem on the deductibility of legal fees, of course, if they constitute expenses incurred in a trade or business. The object is to convert an otherwise miscellaneous itemized deduction (subject to the 2% floor on deductibility and subject to the AMT) into a business expense that is taken "above the line."

That is just what happened in *Thomas F. Noones, et ux. v. Commissioner*, T.C. Memo 2000-106, Tax Analysts Doc. No. 2000-9438, 2000 TNT 61-15. The Tax Court there held that an individual could not deduct legal fees as a business expense, but could only take them as a miscellaneous itemized deduction.

Mr. Noones incurred \$197,000 in legal fees defending himself from an indictment related to his corporation's purchase of a note from the FSLIC. He deducted the legal fees on his Schedule C as a business expense. The IRS would characterize the fees as incurred in the production of income (deductible under Section 212). The result (as we all should know by now) was that the legal fees were subject to the 2% floor. They also generated an alternative minimum tax liability.

The Tax Court agreed with the IRS, noting that Mr. Noones was never regularly engaged in the trade or business of buying and selling underperforming promissory notes, and that the corporation owned the note, not Noones. His corporation should have incurred no legal fees, it would seem!