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Can Execs Deduct Legal Fees Above-The-Line?

No one likes mounting legal bills. Tax deductions can help, but deductible **how**? See [The Only Good Legal Fees Are Tax Deductible Legal Fees](#).



One of the nettlesome tax issues relating to legal fees is the **nature** of the deduction taxpayers receive.

An individual who can only deduct legal fees as a miscellaneous itemized deduction may end up with **no** deduction.

Example: You are subjected to an embarrassing and untrue exposé by a local newspaper and sue for intentional infliction of emotional distress. Your contingent fee lawyer will receive 40%. When the paper offers \$100,000, you accept. Do you have \$100,000 of income or only \$60,000?

Usually \$100,000, which means you must figure a way to deduct the \$40,000 paid to your lawyer. Miscellaneous itemized deductions are deductible only in excess of 2% of adjusted gross income. Plus, they are subject to phase-outs and **no deduction** under the alternative minimum tax (AMT). You end up paying tax on money paid directly to your lawyer.

With higher recoveries and higher fees, the AMT is downright shocking. Costs are treated the same as legal fees so totals can climb to 70% or 80% in some cases. Some clients actually **lose** money after tax by **winning** a lawsuit. See [Spina v. Forest Preserve Dist. of Cook County](#).

Some taxpayers try to get around the AMT by:

- Trying to avoid the attorney fees counting as gross income, which may be possible in some cases;
- Qualifying for an above-the-line deduction (often possible in employment, civil rights and certain other litigation); or
- Keeping litigation within a trade or business thus avoiding miscellaneous itemized deductions.

Sound hopeless? Not always. Take John Ramig, a lawyer and CEO of a failed company who faced legal fees defending a suit by a disgruntled investor. See [Ramig v. Commissioner](#). Ramig formed shoeS4Work to sell safety footwear, was its CEO, a board member, and a minority shareholder.

When the company failed, an investor sued Ramig, shoeS4Work, and five other board members. The suit claimed Ramig made misrepresentations and that the board failed to adequately supervise him. Ramig incurred \$13,000 in legal fees and claimed he could deduct them as ordinary and necessary business expenses.

The IRS argued the suit was against him personally—not as CEO of shoeS4Work—so was unrelated to a trade or business. However, the Tax Court held for Ramig. After all, the performance of services as an employee **can** be a trade or business. See [Biehl v. Commissioner](#).

Whether legal fees incurred in defending a lawsuit arose from a taxpayer's business depends on whether the legal claim originated from that business. In [Ostrom v. Commissioner](#), a taxpayer's legal expenses were deductible because they arose from his misrepresentations of the company's financial status made while performing his duties as the company's president and general manager. Similarly, Ramig's expenses were deductible as expenses of his business of rendering services to shoeS4Work as an employee.

For more, see:

[Legal Fee Tax Rules Every Lawyer Faces](#)

[10 Things To Know About Taxes On Damages](#)

[Legal Fees and Tax Deductions](#)

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

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