



REMAINING TAX BENEFIT FOR PAYMENT OF DIVORCE RELATED FEES UNDER THE 2017 TAX REFORM ACT

BY JOSEPH W. CUNNINGHAM, JD, CPA

Prior to the 2017 Tax Reform Act (TRA), signed into law in December 2017, divorce related attorney fees and accounting fees were deductible as miscellaneous itemized deductions to the extent attributable to:

1. Efforts to obtain taxable alimony, whether successful or not, and
2. Tax advice.

This was beneficial to divorcing parties who saved taxes by deducting such fees. And, it was beneficial to attorneys to inform their clients that, in effect, Uncle Sam was going to subsidize payment of their fees, hence, making them more affordable.

But, under the TRA, the deduction of miscellaneous itemized deductions is *eliminated effective January 1, 2018*.

However, there does remain a little-known tax benefit available incident to the payment of divorce related attorney fees and accounting fees. To the extent such fees are attributable to the property settlement, they increase the tax basis of assets received or retained by a divorcing party. This reduces taxable gain on future disposition.

Exception—The portion of fees allocable to cash cannot increase tax basis since cash can never have a basis higher than face value. Also, the portion allocable to all forms of compensation – payable currently (bonus) or deferred (pension, 401(k) account, IRA) - does not increase the tax basis of such assets.

Further, the amount allocated to a principal residence often will provide no benefit due to the large gain exclusion available incident to sale.

Fees attributable to property settlement include—at least in part—time devoted to discovery, valuation, separate property issues, negotiations, preparation and participation in settlement negotiations, mediation, arbitration, and trial proceedings.

Regarding valuation, if the asset valued is awarded to subject party, the entire fee for the valuation should be specifically allocated to the tax basis of that asset.

Otherwise, the “property settlement” fee should be allo-

cated among assets awarded to subject party proportional to their respective values. Assets for which an increase in tax basis is beneficial include a business, second home, stock portfolio, and other forms of investment holdings.

Example: A divorce in which each party paid \$5,000 for an appraisal of H’s business

Attorney Fees Paid by Each Party:

-	Attributable to child support and spousal support	\$2,000
-	Attributable to working with business appraiser	500
-	Attributable to other property settlement matters	2,500
-	Attributable to other aspects of the divorce proceeding	<u>2,500</u>
-	Total.....	<u>\$7,500</u>

Accountant/Business Appraiser Fees Paid by Each Party:

-	Business valuation	\$5,000
-	Tax advice	<u>500</u>
-	Total	<u>\$5,500</u>

Fees Attributable to Property Settlement:

-	Attorney	\$3,000
-	Accountant	<u>5,000</u>
-	Total	<u>\$8,000</u>

Fees Paid by W, the Non-Business Owner:

- The \$8,000 is allocated among assets awarded to W, including cash and any retirement benefits, proportional to their respective values.
- Fees allocated to cash and retirement benefits do not increase their tax basis and, hence, no tax benefit is received from such fees.

Fees Paid by H, the Business Owner:

- The \$5,500 in fees attributable to the business valuation should be added to the tax basis of the business.

- The \$2,500 balance is allocated among assets awarded to H, including cash and any retirement benefits, proportional to their respective values.

Notification to Clients

Many attorneys provide clients with a letter of “to do’s” at the end of a case. These include changing beneficiary designations, executing deeds, obtaining a QDRO, etc.

Such letter should also include the specific portion(s) of the attorney’s and any expert’s fees attributable to property settlement with the suggestion to consult with a tax specialist to learn how to obtain a tax benefit from such fees.

About the Author

Joe Cunningham has over 25 years of experience specializing in financial and tax aspects of divorce, including business valuation, valuing and dividing retirement benefits, and developing settlement proposals. He has lectured extensively for ICLE, the Family Law Section, and the MACPA. Joe is also the author of numerous journal articles and chapters in family law treatises. His office is in Troy, though his practice is statewide.

Email: JoeCunninghamPC@gmail.com

Website: <https://JoeCunninghamPC.com>