The treatment of divorce costs has changed with the passing of the Tax Cuts and Jobs Act of 2017. Although there is no longer a deduction for professional fee type expenses related to a divorce, there still may be an opportunity to include the expense in the basis of an asset. Generally, there are three aspects of a divorce that could generate the payment of professional fees – alimony, child support and custody, and equitable distribution of the assets.

Prior to 2018, divorce related professional fees were deductible under the Internal Revenue Code (IRC) when there was an attempt at procurement or collection of taxable (alimony) income (even if not successful). In addition, tax advice from an accountant, attorney, or other professional was deductible as a miscellaneous itemized deduction. As of the finalization of the Tax Cuts and Jobs Act signed in December 2017, these amounts are no longer deductible starting in 2018. But, in many circumstances individuals did not benefit from this deduction anyway, due to an inability to itemize, phase-outs for those with too high of income, and the alternative minimum tax. Expenses related to arranging child custody and receiving child support were never deductible and still continue not to be.

Furthermore, if professional fees are paid to assist with equitable distribution of the marital assets these expenses were previously and continue to be not deductible. However, there may be an opportunity to add such expenses to the basis of the property to reduce the gain on the sale of the asset at a later time. The established general rule has been that costs for defending title to an asset can be added to the basis as a capital expenditure. In order to add to the asset basis, one must be able to specifically trace the expenses to the work performed to secure that asset and not simply be the total of all legal expenses paid during a divorce.

In regard to the legal fees added to basis of assets in a divorce settlement, there are prominent cases, but not in recent times. The original decision on this issue is United States v. Gilmore 372 U.S. 39 (1963) which was a California case discussing community property and did not allow legal expenses to be added to the business asset basis since the legal fees originated from a personal litigation (divorce) not business. However, in an appeal Gilmore v. United States 245 F. Supp 383 (N.D.Cal. 1965) it was found that the capitalization of the legal expenses was allowed and added to the basis of the Husband’s stock for retention of the business asset. Prior to this time many cases had left open the issue and did not expressly state that capitalization of expenses was allowed. But in Gilmore, the Supreme Court decided that the government’s position in the initial case (which was that all expenses related to a divorce action should not receive a tax benefit) is not a blanket position that can be taken. Several years later in Spector v. Commission of Internal Revenue, US Tax Court, 71 TC No 1017 (T.C. 1979), it was found that the legal fees associated with settlement could be allocated pro rata among the assets (including cash). Note that when allocated to cash that portion of the legal expense becomes nondeductible (cash cannot have a different basis than what its value is) and therefore unrecoverable. Contemporaneous documentation of the professionals’ time spent on equitable distribution (including specific assets) best supports the basis addition for these costs. This is sometimes straightforward as a business appraisal impacts just one or several designated assets.

When trying to determine what may be recovered in regard to tax savings for professional expenses paid during a divorce, one must take care in analyzing the situation. Based on Spector, if the expenses can truly be traced to assets then those amounts may be added to the basis of that asset. Consult a tax advisor to see if this application can be made to your situation.