UNITED STATES TAX COURT
WASHINGTON, DC 20217

MARIA G. LESLIE,	)	
	)	
Petitioner(s),	)	
	)	
v.	)	Docket No. 15277-17.
	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
	)	
Respondent	)	
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O R D E R

This case is related to others that were originally on the Court's 2014 trial calendar for San Diego, California. Those cases were tried. One was decided, appealed, and affirmed; we remanded the other to the IRS for a supplemental notice of determination that then led to a stipulated decision. A third case was assigned to this division of the Court and also settled.

This case alone remains -- and the parties have been working to settle it as well. They filed a stipulation late last year that resolved all issues except one--whether Leslie may deduct legal fees that she paid in 2010.

Background

Leslie paid all these fees because she was dissatisfied with the terms of her divorce from her former husband Byron Georgiou. In 2002, before the divorce, Georgiou had agreed with a plaintiffs' law firm that he would receive a share of any business that he brought in. And he brought in a whopper -- the firm became counsel for the lead plaintiffs in a class action against Enron, which produced hundreds of millions in legal fees. Georgiou's share of this would turn out to be

about $50 million. But Georgiou ended the marriage before he received this money or knew its precise amount. Leslie was severely affected by the end of the marriage and her mental and emotional health was poor during their negotiations that began in 2003 and continued until 2007.

These negotiations led to a marital settlement agreement (MSA) in which Leslie became entitled to 10% of whatever fee Georgiou received as a result of the Enron litigation. We decided in the earlier case that this amount was alimony and taxable to Leslie. *Leslie v. Commissioner*, 112 T.C.M. (CCH) 313, 317–18 (2016), *aff'd*, 725 Fed. Appx. 597 (9th Cir. 2018).

After Leslie learned how large Georgiou's fee would be, she had second thoughts about the MSA. She ended up paying legal fees in 2010 for three proceedings:

> a motion to set aside the entire MSA on the ground that she lacked legal capacity to consent to the MSA,
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> an order to show cause why Georgiou should nevertheless pay her the share of the fee that she was entitled to under that MSA,[1] and
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> a separate action for damages that she brought against Georgiou in December 2010 for his alleged breach of fiduciary duty to her with respect to the MSA negotiations.[2]

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[1] Georgiou had responded to Leslie's attempt to set aside the MSA by depositing $1.56 million of the Enron fee that he owed her in a trust account for her benefit but to which she did not have access.

[2] California Family Code section 1101 states "[a] spouse has a claim against the other spouse for any breach of the fiduciary duty that results in impairment to the claimant spouse's present undivided one-half interest in the community estate * * * ." Cal. Fam. Code § 1101(a).

The Commissioner has moved for summary judgment on this issue. He argues that Leslie's legal fees are all nondeductible because they stem from the couple's divorce and are therefore personal. Leslie argues that they are all deductible because she paid them to secure more "Enron money," money we found in her earlier case was alimony and properly included in her income under I.R.C. § 71(a).

Discussion

Section 212 allows a taxpayer to deduct all the ordinary and necessary expenses that she pays to produce or collect income. Section 262(a) then limits this general rule by disallowing any deduction for personal or family expenses. I.R.C. § 262(a); 26 C.F.R § 1.262-1(a). One regulation specifically classifies attorney's fees paid in connection with a divorce or separation agreement as not deductible because they are personal. *See* 26 C.F.R. § 1.262-1(a). That same regulation, however, states that "the part of an attorney's fee and the part of the other costs paid in connection with a divorce, legal separation, written separation agreement, or a decree for support, *which are properly attributable* to the production or collection of amounts includible in gross income under section 71 [i.e., alimony] are deductible by the wife under section 212." 26 C.F.R. § 1.262-1(b)(7) (emphasis added).

How we rule on this motion thus comes down to whether Leslie's fees are "properly attributable" to the production or collection of alimony rather than other costs of divorce.

Here we have case law to guide us. And, as the Commissioner points out, that case law tells us to look to the origin of the claim, not the purpose or hoped-for outcome of a lawsuit. We must follow the guidance of the Supreme Court:

> [T]he characterization as "business" or "personal," of the litigation costs of resisting a claim depends on whether or not the claim *arises in connection with* the taxpayer's profit-seeking activities. It does not depend on the *consequences* that might result to a taxpayer's income-producing property from a failure to defeat the claim.

United States v. Gilmore, 372 U.S. 39, 48 (1963) (emphases in original) (and though in *Gilmore* the Court spoke of the costs of "resisting" a claim, the same

rules apply for prosecuting a claim. *See generally Wild v. Commissioner,* 42 T.C. 706 (1964) (allowing the deduction of attorney's fees for a wife who initiated suit for legal separation)).

Even before *Gilmore*, this distinction between the expenses of litigating a divorce (nondeductible) and collecting alimony (deductible) was one that we ourselves drew. In *Gale v. Commissioner,* 13 T.C. 661 (1949), we allowed a deduction for attorney's fees where the taxpayer paid them

> solely for the purpose of producing or collecting increased alimony for past and future years and was in no respect paid in with the personal marital difficulties of petitioner and her husband, which had been settled by separation and divorce over three years before the suit in question was commenced by the petitioner.

Id. at 669; *c.f.*, *Wolfson v. Commissioner*, 47 T.C. 290, 295 (1966) (costs of litigating distribution of community property nondeductible); *Fleischman v. Commissioner*, 45 T.C. 439, 440 (1966) (costs of litigating validity of antenuptial agreement nondeductible); *Wild*, 42 T.C. at 709–10 (distinguishing deductible costs of fees to litigate alimony from nondeductible other costs of litigating divorce).

We understand Leslie's argument that if she had won her attempt to set aside the MSA or proved that Georgiou had breached a fiduciary duty to her in its negotiation, then she might have received a larger share of the Enron fee and included it in her taxable income. But we rejected a very similar argument in *Barry v. Commissioner*, 114 T.C.M. 610 (2017) where a former husband sued his ex for an overpayment of alimony. He argued that if he recovered the overpayment he would have had to include it in his taxable income and so should be allowed to deduct the costs of litigating the matter. We disagreed, however, because we found that the litigation arose from the marital relationship. That was enough to make it personal, even if it had produced taxable income as a result. *Id.* at 612–13.[3]

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[3] We must acknowledge that we are not always consistent. *See, e.g., Seidel v. Commissioner,* 89 T.C.M. 972 (2005). In *Seidel*, we allowed a deduction for negotiating division of a 401(k) plan because it produced taxable income. *Id.* at 980. On this motion, we give greater weight to our opinions that expressly apply the origin-of-the-claim test that the Supreme Court described in *Gilmore.*

Deciding this motion thus comes down to a single question -- are Leslie's litigation expenses properly attributable to the production or collection of *alimony,* and not attributable to her seeking a better split of her community property with Georgiou or some other consequence of her marriage to him.

We look at each piece of litigation separately.

The litigation to set aside the MSA for lack of legal capacity. Leslie argues that the clear goal of this action was to receive more Enron money, which then would have been taxable to her as alimony. But that argument is one that focuses on the consequences of her possible victory, not the origin of the claim. The origin of the claim for this litigation was an alleged flaw in the formation of the MSA, not a claim to more alimony under the MSA or some other basis. Even if we focused on the consequences of this litigation, Leslie would lose because success wouldn't directly lead to more Enron income, but only to the setting aside of the MSA. The California Superior Court would have ordered a new division of marital assets. This division of assets -- unless a separate agreement was reached -- would have split all the community property and debts in half. And an action to divide community property is not an action for alimony. *See* I.R.C. § 1041; *Wolfson,* 47 T.C. at 294.

The litigation to compel distribution of alimony. Leslie also moved for an order to show cause to get the money that Georgiou had stashed in a trust account to which she had no access. Her right to this money was established in the MSA and characterized there as alimony. This claim did arise from her legal right to alimony, and attorney's fees to vindicate it are therefore deductible. Here we emphasize that we also understand the Commissioner's argument -- Leslie wouldn't have had to litigate this if she hadn't been trying to upset the MSA. But we can see no dispute that her claim to the money in the trust account arose from her right to alimony as defined in the MSA. This means that costs for litigating this claim fall within the exception to the nondeductibility of marital-litigation costs of seeking alimony.

The litigation to recover damages for breach of fiduciary duty. Leslie argues that this also was a suit to produce or collect alimony. It was brought, however, under California Family Code § 1101. This law establishes that a fiduciary duty exists between spouses that requires them to fully disclose "to the other spouse * * * all material facts and information regarding the existence, characterization, and valuation of all assets in which the community has or may

have an interest." Cal. Fam. Code § 1100(e). The remedy that Leslie sought was essentially a percentage of the value of Georgiou's Enron fee that she claimed he had not fully disclosed. *Id.* § 1101(g)–(h). This claim might have led to an increase in her share of the Enron fee, which might have been characterized as alimony (but which might also have just been characterized as a division of future community income) -- but the claim arose from her being married to Georgiou. There is no dispute that any of the fees she paid in connection with this litigation were not for the production or collection of alimony.

This is something of a split decision, so it is

ORDERED that respondent's motion for summary judgment is granted in part as to the fees related to the litigation to set aside the MSA for lack of legal capacity and fees related to the litigation to recover damages for breach of fiduciary duty. It is also

ORDERED that respondent's motion for summary judgment is denied in part as to the fees related to the litigation to compel distribution of alimony. It is also

ORDERED that on or before November 27, 2019 the parties submit settlement documents or file a status report describing their progress, and especially whether they have been able to settle the issue of the deductibility of Leslie's 2010 attorney's fees in accordance with this order.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
September 27, 2019