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## Contingent Fee Tax Advice: IRS Allows Some, Not All

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Contingent legal fees are customary in personal injury cases. Increasingly, they are the norm in employment lawsuits too. Indeed, the variety of cases in which contingent legal fees are common is still expanding. These days, even large law firms may handle some cases on contingency. So, how about paying your tax adviser a percentage of the tax money he saves you? It should not be surprising that clients ask for this. Why *wouldn't* a client want legal or accounting fees tied directly to the tax result?

However, it turns out that tax advice or representation for contingent fees is the exception, not the norm. One place where contingent fees may be especially useful is where the taxpayer is trying to get money back from the IRS in a lawsuit. Tax refund suits may lend themselves to contingent fees, and the IRS has approved contingent fees in that context. Yes, that's right, this is an area regulated by the IRS. So to start, whether your tax adviser can offer you services on a contingency depends on what contingent fees are *allowed* by the IRS. In regulations known as [Circular 230](#), the IRS says that a practitioner cannot charge a contingent fee for services rendered in connection with *any* matter before the IRS, with three exceptions.



The first exception is that a contingent fee can be charged in connection with an IRS audit or challenge to (a) an original tax return; or (b) an amended tax return or refund claim, if it was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return. Second, a contingent fee can be charged in connection with a refund claim filed for penalties or interest assessed by the IRS.

Third, a contingent fee can be charged in

connection with any judicial proceeding arising under the Internal Revenue Code. The IRS would be happiest if your tax adviser sticks to these three permitted exceptions. However, in *Ridgely v. Lew*, 55 F. Supp. 3d 89 (D.D.C. 2014), a federal District Court held that the IRS had overstepped its authority with these rules. It is unclear where this leaves contingent fees, but the IRS still thinks it is right. What's an example of a fee that is clearly not OK in the IRS view? Tax return preparers cannot charge a fee tied to the size of your tax refund, to how many additional write-offs they find you, etc.

Still, that leaves plenty of room. How do the IRS's three exceptions apply in practice? Say the IRS notifies Abe that he owes \$1 million in taxes. Abe hires a lawyer or accountant to negotiate an offer in compromise for him. The fee is 30% of any tax savings. This seems fine, because the \$1 million tax liability grows out of an IRS examination or challenge to a filed tax return.

What if Billy asks his lawyer to sue the IRS for a refund on a contingent fee basis. He filed his 2015 return reporting ordinary income on a big contract disposition. Later, he filed an amended 2015 return, claiming that it was capital gain. He didn't get his refund, and now he wants to sue. Billy is suing, so a contingent fee is fine. What if Billy wants a contingent fee *before* he files his amended return for 2015? With this timing change, a contingent fee might not be available, according to the IRS. However, under the *Ridgely* case, preparing an amended tax return, by itself, is not *practice* before the IRS. *Ridgely* suggests that the IRS can't regulate this.

Tax audit disputes can be done on contingency too. Say that Dennis's 2013 tax return was audited. His accountant represented him, but eventually, the IRS issued a Notice of Proposed Adjustment asking for \$1 million in additional taxes. Can Dennis hire a tax adviser to represent him in a protest, and thereafter at the IRS Appeals Office, on a contingent fee basis? Sure, because it is about an IRS challenge to Dennis's original return.

In all of these situations, just be aware that the IRS has views about what is permitted.

*For alerts to future tax articles, email me at [Wood@WoodLLP.com](mailto:Wood@WoodLLP.com). This discussion is not legal advice.*