Revisiting Structured Legal Fees: Where Are We Now?

by Robert W. Wood

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In this article, Wood revisits structured attorney fees, which have been around for over three decades, taking a look at their history and how they have changed.

This discussion is not intended as legal advice.

For many plaintiff lawyers, cases ground to a halt with COVID-19-related court closures and other even bigger national and global developments. Yet some cases were resolved or are resolving, and lawyers are trying to optimize their receipt of income. Some need cash above all, while others are interested in fee structures — even more than in the past. Apart from many other lessons, COVID-19 has provided another example of the dramatic peaks and valleys of income that lawyers may experience.

As the economy struggles to recover, we can expect the flow of settlements to turn from a drip to a solid stream. As it increases, the flow of settlements for some lawyers may seem like drinking from a fire hose. That might sound nice, but it can be inefficient from a tax viewpoint. Structuring legal fees can help make it more manageable.

Contingent fee lawyers are unique in their ability to defer the receipt of legal fees and have them invested pretax to be paid and taxed later. Most lawyers, other professionals, and businesspeople cannot do this. Structured legal fees are exempt from section 409A,[1] a scary IRC section that taxes many types of deferred compensation. Moreover, there is favorable tax authority that allows contingent fee lawyers the luxury of timing payments — if they color within the lines.

Coloring within the lines is important, and yet there can be differences of opinion about what that means. Structured legal fees have been around for decades, emanating from *Childs*, a Tax Court case in which the IRS tried to attack structured fees and lost.[2] The IRS took the case to the Eleventh Circuit and lost there, too. For a time, the IRS grumbled about *Childs*, but before long it started citing the case with approval.

Childs involved structuring fees with annuities, and several life insurance companies continue to offer these arrangements. There is nothing wrong with annuities and nothing wrong with following *Childs* to the letter. Yet in the past three decades, during which structured legal fees have gained acceptance and popularity, many lawyers who wanted a bigger engine and faster car have moved away from annuities.

Financial firms offering more flexible non-annuity brands of structured legal fees have provided alternatives. There are variations in approaches, but there appears to be nothing

[1] Enacted in 2004, section 409A drastically changed the landscape for deferred compensation. In the structured settlement industry, section 409A triggered concern about attorney fee structures. However, not long thereafter, the IRS issued Notice 2005-1, 2005-1 C.B. 274, which provides that section 409A does not apply to arrangements between a service provider and a service recipient if (1) the service provider is actively engaged in the trade or business of providing substantial services (other than as an employee or corporate director), and (2) the service provider provides those services to at least two unrelated service recipients.

[2] *Childs v. Commissioner*, 103 T.C. 634 (1994), *aff'd without opinion*, 89 F.3d 856 (11th Cir. 1996).

magical about life insurance annuities in this context.[3] Alternative investments are permitted as long as the teachings of *Childs* are followed and the lawyer remains a mere payee, without ownership or control over the deferred fees. Yet precisely how these structured fee arrangements hang together varies.

Assignment Companies

The companies modeling their approach most closely after *Childs* use an "assignment company," often one based offshore in a tax treaty jurisdiction. An assignment is simply the defendant's legal transfer of its obligations to make the stream of deferred payments to the lawyer. The assignment concept comes directly from the parallel historic architecture of structured settlements for plaintiffs. The assignment company will receive the cash to invest and fund those payments.

But the assignment company does not want to pay tax on the lump sum it receives. There are two possibilities. If the client's recovery is excludable under section 104, and the lawyer is structuring fees, some companies use a qualified assignment under section 130. In that event, there is no need for an offshore assignment. Section 130 protects the assignment company from paying tax on the lump sum.

In other cases, a nonqualified assignment could create tax risk for the assignment company, so a tax treaty country is the usual answer. Thus, the reason for the location of the assignment company does not relate to the tax treatment of the structuring lawyer, but rather to the structure company and the pool of assets that will finance the lawyer's deferred fee. The tax opinions I have written for attorneys on structured fee arrangements have concluded that the attorneys should not be taxed until they receive distributions.

Notably, I use the word "should" here not in its technical tax sense, as in a "should opinion," but more colloquially.[4] Opinion standards vary with the documents and facts. The tax opinions I have issued to providers of these arrangements reach a similar conclusion about their customers — that is, that the lawyers who structure fees with them should not be taxed until they receive payments.

However, it is worth asking whether the assignment company could be required to pay tax generated by the pooled funds while they are invested and *before* they are paid (years later) to the lawyer. These products are typically structured in such a way that incremental investment income should face little or no tax.

Most providers use an overseas assignment company that owns the account with the securities. Some providers may allow the limited segregation of assets within such an arrangement, but plainly, the attorney cannot own the securities or have legal rights in them. If the assignment company is foreign, it will be in a country with a favorable tax treaty with the United States.

The most popular such country is Barbados, although some now use Ireland. Barbados became popular over 20 years ago with U.S. life insurance companies that formed assignment company subsidiaries there for use in non-tax-free cases. By non-tax-free, I mean cases in which the plaintiff or attorney destined to later receive periodic payments will pay tax on those payments when and as received.

That stands in contrast to the original form of structured settlements (going back four decades) in which injured plaintiffs would receive a series of periodic payments, with each payment being tax free.[5] In these "qualified assignments," section 130 protects the assignment company from a major tax hit when it is paid to assume the defendant's settlement obligations. Thus, with a qualified assignment it does not matter where the assignment company is — it can be in the United States. In non-tax-free cases (including most legal fee structures), using a foreign tax treaty jurisdiction can help the offshore owner of the assets steer clear of most U.S. corporate income tax.

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[3] Robert W. Wood, "Structuring Legal Fees Without Annuities: Offspring of *Childs*," *Tax Notes*, July 20, 2015, p. 341.

[4] Wood, "The Uneasy Topic of Tax Opinion Standards," *Tax Notes Federal*, Dec. 16, 2019, p. 1823.

[5] For discussion on the two types of structures and the private letter ruling on structures of the taxable variety, see Wood, "Nonqualified Settlement Ruling Spurs Damage Structures," *Tax Notes*, July 14, 2008, p. 141.

Even in the absence of a tax treaty, the United States does not tax foreign persons or companies on capital gains on intangible assets. Dividends and interest are more nuanced, as U.S. withholding tax could apply subject to a treaty. The result is that with tax treaty protection from either Barbados or Ireland there should be little or no U.S. tax on income generated by the assets that make up the eventual source of the periodic payments to the lawyer.

However, that does not necessarily mean zero tax. The value of the notional investment portfolio might be reduced by any mandatory income tax withholding to which an actual portfolio would be subject. Even under a tax treaty, there may be some tax liability.

Non-Assignment Companies?

Several providers of structured legal fees do not appear to use an assignment company structure at all. These offerings appear to be based on a deferred compensation model. To my mind, these offerings do not track the *Childs* methodology with the same care. Of course, that does not mean they cannot work.

There are certain structural differences, including an election to defer compensation. Deferred compensation authorities are certainly relevant, and are discussed in some of the authorities that follow. They may also give the counterparty the right to re-defer previously deferred amounts. That is something that can be OK in the tax authorities governing deferred compensation. Yet re-deferrals were not embraced by the *Childs* court; in fact, the court suggested that you cannot do it.[6] Yet with the assumed easing of the *Childs* fact pattern over the years, re-deferrals of payments within limits seem common now in many fee structures.

Qualified Settlement Funds

Qualified settlement funds (QSFs) are increasingly used as a bridge between plaintiffs and defendants. This is as it should be. A QSF allows plaintiffs and their lawyers to decide who gets what, when they get it, and how they get it (cash or structured payment) once the defendants are out of the picture. In my view, it is even possible to use a QSF when there is only one plaintiff.[7]

Of course, the genesis of QSFs came from messy cases, in which there could be disputes and discussions among plaintiffs and lawyers, lien claims, and so on. Defendants were the intended beneficiaries that led Congress to enact section 468B, so they could get a tax deduction on contributing the money, even if it took years for the plaintiffs and lawyers to agree on distributions. But over the decades, QSFs have exploded like wildfire.

However, a QSF should be a temporary vehicle, not a permanent deferral vehicle that pays out a stream of periodic payments to a plaintiff for years. Similarly, it should not be a vehicle that invests and pays out structured legal fees for years. There is enough material to write a separate article on this topic. But for now, I will merely say that QSFs were never intended to make long-term payouts of this sort.

For one thing, the high entity-level tax on all the QSF's investment income[8] would spoil one of the touted benefits of the structured legal fee. For another, there is a serious question whether a long-term captive QSF would continue to qualify as a QSF with its meant-to-be-kryptonite protection from the constructive receipt and economic benefit doctrines. In short, don't do it.

My Brother-in-Law the Broker

Finally, some providers fees and similarly minded do-it-yourselfers seem to take a wide view of what *should* work. More than a few banks and investment advisers have poked around the topic of offering structured legal fees to their customers. I do not know for a fact how many are doing this, or with what care they may have proceeded.

But I have encountered a surprising level of naiveté over the years, even from financial institutions that should know better. "The lawyer can't own the assets, so we'll just have a trust account and invest for him!" "We'll get famous

[6] Wood, *supra* note 3.

[7] *See* Wood and Alex Brown, "Actually, Single-Claimant Settlement Funds Are Valid," *Tax Notes Federal*, Feb. 10, 2020, p. 957.

[8] Under section 468B(b)(1), a QSF is taxed at the highest rate specified in section 1(e).

and wealthy plaintiff lawyer clients this way; we'll structure and invest their big fees!"

I am not making this up.

More than a few do-it-yourself lawyers seem to be in this scary category too. It is not a pretty picture to imagine a poorly structured arrangement coming apart. There can be serious statute of limitations issues too: Most fee structures are vulnerable for at least six years. After all, a six-year statute of limitations applies to an understatement of gross income of 25 percent or more.

Even worse, some might conceivably be vulnerable to civil fraud claims. The IRS statute of limitations on civil fraud, it's worth remembering, never runs out. While surely no lawyer would intentionally set up a fee structure that would fail the tests, some are ill-considered enough that I can at least imagine the IRS asserting civil fraud. The IRS has a hard time collecting the 75 percent civil fraud penalty, but the statute of limitations issues are still worth considering.

Borrowing and Attorney Fee Structures

When *Childs* was decided over 25 years ago, perhaps no one considered borrowing. Of course, borrowing from life insurance policies is virtually as old as the hills, and no one bats an eye. Still, structured legal fees are different, and increasingly likely not to involve annuities at all. So, is borrowing OK?

The reality is that attorney fee structures are increasingly likely to permit borrowing or to recognize that a borrowing facility may be allowed, subject to conditions. Ideally, there will be time, entity, and procedural distancing between the structure and any loans. Indeed, the attorney should not be seen as borrowing money out of the fee structure. The fee structure company and the lending company may be entirely unrelated, or the companies may be related but may each have their own protocols to make their respective transactions independent and valid.

The mechanics of the fee structure and loan may be staggered. Due dates and payment details may be scrutinized in a conscious effort to avoid bad optics. Without safeguards, it might appear that the money from a fee structure goes round trip into the lawyer's hands not as income but as a loan. Entities should be kept straight, borrowing ratios should be observed, and rates and protocols should be in place.

These details may seem unimportant to the plaintiff's lawyer, who can perhaps be forgiven for thinking in shorthand. The lawyer's shorthand might be: "I'll structure fees to provide regular annual cash flow and to defer taxes. And I can always borrow my own money when needed." The reality should be otherwise.

So that the lawyer can be allowed to think in those terms, the professionals involved must be diligent in dotting the i's and crossing the t's. This applies to the structure documents and to any loan documents too. In general, the proceeds of a loan are not income if the taxpayer is obligated to repay it.[9] Of course, a sale or disposition of a lender's collateral can trigger income,[10] yet there does not appear to be any authority directly addressing a loan from an attorney's structured fee.

In other contexts, the IRS has shown an interest in transparency and matching. Thus, in *Heyn*, a plaintiff settled an employment dispute in exchange for five annual payments of $9,100.[11] At the same time, however, the employer "loaned" the employee $41,835 (the present value of the five annual payments).

The employee issued five promissory notes to exactly offset the annual payments. The Tax Court in *Heyn* held that the $41,835 was income, not a loan. The taxpayer's obligation to repay exactly matched the future payments, so neither party had any obligation to actually pay. The details, terms, and circumstances matter in determining whether an advance will be respected.

One of the requirements for an advance ruling that a nonqualified deferred compensation plan does not result in constructive receipt is that the service provider not be permitted to pledge, encumber, assign, transfer, or alienate the stream

[9] *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 207-208 (1990) ("It is settled that receipt of a loan is not income to the borrower."); *Commissioner v. Tufts*, 461 U.S. 300, 307 (1983) ("When a taxpayer receives a loan, he incurs an obligation to repay that loan at some future date. Because of this obligation, the loan proceeds do not qualify as income to the taxpayer.").

[10] *See Calloway v. Commissioner*, 691 F.3d 1315 (11th Cir. 2012) (treating a nonrecourse loan at 90 percent of the value of securities pledged as a sale of the securities rather than a mere pledge).

[11] *Heyn v. Commissioner*, 39 T.C. 719 (1963).

of future payments.[12] In one ruling, the IRS held that a combined note, pledge agreement, and bonus agreement constituted compensation for future services, not a bona fide loan.[13]

The employee received an upfront loan, signing a promissory note. He pledged his future bonus payments to secure the note. The employer agreed to pay annual bonuses exactly equal to the note amounts. The IRS acknowledged that the transaction took the form of a loan, but the employee had no unconditional and personal liability. The note would be repaid with guaranteed bonuses exactly matching the note payments. Thus, it was current compensation.

However, in *Dennis*, an insurance agent received advances secured by future commissions.[14] Although the balance of his advances was reduced by commissions, he had an unconditional obligation to repay. The Tax Court therefore respected the advances as loans.[15] In contrast, when an employee's obligation to repay is only *conditional*, it is generally regarded as current compensation.[16]

In fact, the IRS has stated that an advance to an insurance agent qualifies as a loan if: (1) the advance takes the form of a loan and interest is charged; (2) the agent is personally and unconditionally liable; and (3) the employer actually or in practice demands repayment if the future commission income is not sufficient for repayment.[17] For a client's loan to his attorney to be respected, the attorney must have an unconditional, personal obligation to repay principal and interest.[18]

Loan payments should not match periodic payments, and the attorney should remain entitled to the periodic payments, even on a default under the loan.[19] The loan and the stream of periodic payments should be independent obligations, as they were in *Mastroeni*.[20] In that case, the bank was a lender to the taxpayer and the custodian of the taxpayer's IRA.

Moreover, the bank had no right to offset the IRA. Thus, even on a loan default, the structure company should ideally be required to pay the attorney's periodic payments on schedule. The lending entity will typically be a general creditor of the attorney, but it can also take a security interest in the attorney's assets *other* than in his rights against the structure company. With appropriate documentation and distance, it should be possible to have a bona fide legal fee deferral and a bona fide loan, and not to have them collapsed.

It is an understatement to say that the devil is very clearly in the details. Perhaps the best fact pattern would be to have truly independent and independently owned structure companies and loan funding entities. The parties should all behave in a commercially reasonable manner. The lending entity should require a loan application, credit report, etc. The more independent and arm's-length the relationship, the better. You may not be able to tick all of these boxes, but try to tick as many as you can.

Coloring Within the Lines

Formality and form in structured legal fees are very important. The lawyer must sign the structure documents *before* the settlement documents are signed. The lawyer must be unable to accelerate, pledge, defer, or otherwise change what he is promised to receive over time. The lawyer contracts for a series of payments before the case settles and before he formally earns his fee. The attorney may be empowered to pick investments or managers *before* signing, but not thereafter.

The lawyer must be a general creditor with no right to accelerate, defer, or assign the right to

[12] Section 5.02 (model trust provisions); Rev. Proc. 92-64, 1992-2 C.B. 422.

[13] TAM 200040004.

[14] *Dennis v. Commissioner*, T.C. Memo. 1997-275.

[15] *See also Gales v. Commissioner*, T.C. Memo. 1999-27.

[16] *Winter v. Commissioner*, T.C. Memo. 2010-287 (advance treated as compensation when employee did not have unconditional obligation to repay).

[17] *Dennis*, T.C. Memo. 1997-275; *Gales*, T.C. Memo. 1999-27.

[18] *See Mathers v. Commissioner*, 57 T.C. 666, 675 (1972) (noting that the transfer of the installment obligations did not take the form of a loan agreement); *Heyn*, 39 T.C. 719 (holding that promissory notes were to be disregarded in part because taxpayer did not expect to ever pay any amount on the notes).

[19] *See Town and Country Food Co. Inc. v. Commissioner*, 51 T.C. 1049, 1057 (1969), *acq.*, 1969-2 C.B. xxv (explaining that the pledge of installment obligations would be respected as a mere pledge in part because the repayment of the loan "was not geared to the [taxpayer's] collections upon its installment obligations").

[20] *In re Mastroeni*, 57 B.R. 191 (Bankr. S.D.N.Y. 1986).

receive the periodic payments. The fact that there is a formulaic investment return should not create problems. In a letter ruling (LTR 199943002), the IRS held that periodic payments determinable by reference to the S&P 500 stock index or a portfolio to achieve long-term growth and moderate current income qualified under section 130(c).[21]

Investment selections must be made before the case settles. The attorney can have no security or any rights to the underlying assets. The agreement must not create an escrow account, trust fund, or other form of asset segregation. The benefits cannot be subject to anticipation, alienation, sale, transfer, assignment, pledge, or encumbrance.[22]

Can the attorney import his own investment manager? How about dividend rights on any reference securities being purchased as part of the portfolio? If there is an annuity contract, the attorney should not own or hold it — the assignment company should, although the attorney can be designated to receive the payments.

All the documents should be clear that the attorney has no right to accelerate any of the payments. The attorney must agree to a fee structure *before* the case is resolved. That means that before the client signs any settlement documents, the structure must be in place. Ideally, the contingent fee agreement with the client should specify that the attorney has the right to elect to take his fees in that way before the conclusion of the case.

Cash Equivalency and Constructive Receipt

Many nonstatutory tax concepts affect structured attorney fees, and they are worth a refresher. Under the cash equivalency doctrine, if a promise to pay a benefit to an individual is unconditional and exchangeable for cash, the promise is currently taxable.[23] Attorney fee structures should state that rights under the contract cannot be assigned, transferred, pledged, or encumbered. That should make it unlikely that the cash equivalency doctrine will be applied.[24]

Constructive receipt authorities are tougher, particularly because the attorney fee seems *almost* earned when agreements in principle are reached. Constructive receipt is the universal notion in tax law that you cannot turn down money you are entitled to receive without tax consequences. The constructive receipt doctrine does not apply to a properly documented structured attorney fee because the structure is put in place *before* the case settles. The fee is not actually *earned* until settlement documents are signed.

The Tax Court approved structured fees in *Childs*, and the Eleventh Circuit affirmed. Since then, the IRS has routinely cited *Childs* with approval.[25] As the years have elapsed, the importance of sticking with the *Childs* fact pattern, even if one strays from life insurance annuities, seems clear. Yet some variations are not so clear.

For example, what about allowing re-deferrals of previously deferred funds? *Childs* bears many similarities to section 130 qualified assignments, including the prohibition against re-deferral.[26] The prohibition of re-deferral rights in section 130(c)(2)(B) suggests that the government could see re-deferral as material to the result in *Childs*. On the other hand, the fact that re-deferrals seem common now may suggest that the industry is comfortable with them.

Incidents of Ownership

Any of these issues could be more worrisome if one adds other innovations like importing of the attorney's own investment manager, dividend or voting rights on securities, and so on. Plaintiffs' lawyers are paid for being aggressive, and successful ones may be more so. Fee structure companies may be pushed to accommodate requests from plaintiffs' lawyers to add or subtract features.

What about importing the attorney's own investment manager and even letting him direct

[21] *See* Rev. Rul. 2008-31, 2008-1 C.B. 1180 (investors were not owners of U.S. real estate when they invested in a broad-based index that sought to measure appreciation and depreciation of residential or commercial real estate in large geographic areas).

[22] Rev. Rul. 72-25, 1972-1 C.B. 127.

[23] *Cowden v. Commissioner*, 289 F.2d 20 (5th Cir. 1961), *rev'g and remanding*, 32 T.C. 853 (1959), *opinion on remand*, T.C. Memo. 1961-229.

[24] *See Reed v. Commissioner*, 723 F.2d 138 (1st Cir. 1983); *Johnston v. Commissioner*, 14 T.C. 560 (1950).

[25] *See* FSA 200151003; 2001 IRS CCA LEXIS 368 (Nov. 1, 2001); LTR 200836019.

[26] Section 130(c)(2)(B).

individual trades? Why not add dividend or voting rights on any securities that the assignment company happens to hold, despite the smoke and mirrors, essentially for the lawyer's account? Some of these questions may answer themselves, but many questions may be ones of degree, of safety versus innovation.

As more companies attempt to add to the smorgasbord that attorney fee structures seem to allow, caution is clearly in order. A lawyer's own investment manager could have a role in managing an array of reference securities. These securities should not be set aside for the lawyer and should not be available to the lawyer in any way. This may well be shoehorned into the *Childs* fact pattern, but consider the overall optics too.

Is this enough control or attribution to spell constructive receipt? Perhaps not, but it is worth examining each point one by one, and then taking a view of how it all fits together. Is the spirit of *Childs* respected? Exactly how those additional bells and whistles will be viewed by the IRS is not yet clear. Yet it is hard to argue that they (particularly in combination) would pass the IRS entirely unnoticed in an audit.

In *Goldsmith*,[27] the IRS argued that the taxpayer was in constructive receipt of deferred compensation when he chose the annuity company to receive a monthly premium deducted from his salary. However, the court held that the mere ability to choose the annuity company did not spell constructive receipt. The optics matter, as do the additional bells and whistles one might add that were not present in *Childs*. The IRS can scrutinize each right or incident of ownership or control, as well as their effect in the aggregate.

In Rev. Rul. 77-85, 1977-1 C.B. 12, a policyholder entered into a contract with an insurance company. The custodian bought and sold securities and reinvested earnings based on the policyholder's instructions. The policyholder could direct the custodian in voting the securities. Ruling that the policyholder was the beneficial owner, the IRS noted that they retained significant incidents of ownership. The policyholder continued to hold the power to direct purchases, sales, and voting. These extensive rights made the policyholder the owner of the assets.[28]

Similarly, in *Christoffersen*,[29] the court treated the taxpayer as the owner of invested assets for tax purposes. Rev. Rul. 2003-91, 2003-2 C.B. 347, suggests that policyholders can avoid ownership by avoiding specific investment directives. In contrast, Rev. Rul. 2003-92, 2003-2 C.B. 350, considered variable annuity contracts, in which the policyholder could invest in publicly available investment funds and was therefore treated as their owner for tax purposes. Only in limited circumstances with nonpublic funds could the policyholder sidestep ownership.

These issues are not unique to attorney fee structures. The IRS has considered dominion and control in nonqualified deferred compensation plans. In one general counsel memorandum, the IRS discussed nonqualified deferred compensation arrangements allowing employee elections to have pay withheld and invested.[30] The IRS argued that the employees should be taxed because they exercised dominion and control over the investment of the funds.[31]

Some thought should be given to the golden rules of *Childs*. It is one thing to move beyond life insurance annuities. After all, the funding asset itself really should not matter. But one should still adhere to all the rules that the *Childs* court said were important — at least whenever one can. They include no rights beyond contract rights, no acceleration, no right to re-deferral, and no pledging.

Sure, aggressive plaintiff lawyers are going to push. But one should be careful about chipping away at these limitations. One should be careful about adding wholly new rights. Permitting the attorney to inject his own investment manager may well be fine, but think about the plusses and

[27] *Goldsmith v. United States*, 218 Ct. Cl. 387, 399 (1978).

[28] *Cf.* Rev. Rul. 80-274, 1980-2 C.B. 27 (annuity policyholder treated as owner of savings and loan accounts when the insurance company that issued the annuity acted as "little more than a conduit" between the policyholder and the savings and loan association).

[29] *Christoffersen v. United States*, 749 F.2d 513 (8th Cir. 1984), *cert. denied*, 473 U.S. 905 (1985).

[30] GCM 36998 (Mar. 29, 1978).

[31] However, in 1978 Congress passed the Revenue Act of 1978 expressing disagreement with the restriction on those deferred compensation arrangements. In the Revenue Act of 1978, Congress added section 457, providing rules for the taxation of deferred compensation plans of state and local government.

the minuses. With any "new and improved" mousetrap, consider the technical rules.

Besides, even if one can make the mousetrap technically work, consider the optics. For example, under section 409A, some limited investment changes are allowed without being considered a material modification to a deferred compensation plan.[32] However, one should feel uneasy relying on section 409A when it isn't supposed to apply to attorney fee structures in the first place. *Childs* requires that periodic payments not be increased or decreased by the attorney. Notional investment requests made after the agreements are signed should be viewed with caution. If allowed, they should be nonbinding and made based on a predetermined menu of available investments.

Last Word

Contingent fee lawyers are unique in being able to defer their legal fees. Investing those fees pretax is an awfully attractive benefit. And while it is true that the lawyer must defer the fees before they are earned, that can be done at the last minute. Is it realistic to say that a lawyer earning a 40 percent fee for 10 years of hard-fought litigation really has not earned anything up until the moment before the settlement agreement is signed?

In a very real way, we all know that *most* of the fee was already earned. If the law firm was coming apart at the seams the night before the settlement, the lawyers would probably be arguing that each was entitled to a share of the fee, that it was fully earned and literally in the bag. But as long as the structured fee arrangement is put in place at least a moment before the settlement agreement is signed, the fees can be deferred.

Those are the rules, and these days that usually means deferred fees go into a portfolio of investments. Borrowing facilities should have independent significance, ideally with different parties, different timing, and payment protocols with no security or pledging. Fee structure documents should adhere (as much as possible) to the restrictions of *Childs*. The principles of constructive receipt, economic benefit, and cash equivalency serve as the lines that one must stay within. The IRS appears to be comfortable with properly and timely documented attorney fee structures. Aggressive attorneys who push the envelope a little too far might be rocking what so far appears to be a largely smooth-sailing boat. ■

[32] Reg. section 1.409A-6(a)(4)(iv).