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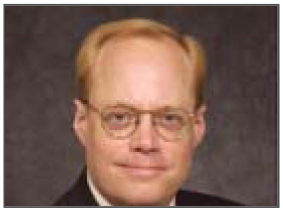

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Tax Break Just For Lawyers

A “structured legal fee” sounds like a Wall Street product. Actually, it is a creature of the life insurance industry. Every lawyer should know what it is. And lots of non-lawyers should be envious. It works like this.

Only plaintiffs’ lawyers on a contingency can structure their fees. Defense lawyers cannot. When a case settles, the defendant pays a third-party annuity provider so the plaintiff’s lawyer receives a stream of payments over time. Structures offer tax, investment and asset protection advantages.

Many plaintiffs’ lawyers lament the unpredictability of their incomes. Structured legal fees allow a lawyer to select how much he wants to accept now v. later. Plaintiffs’ lawyers charging a contingent fee are in a unique position to plan their income and save taxes. Virtually no other service provider can arrange a funded payment over time that the IRS will respect.

What’s more, all the arrangements can be done on the eve of settlement. Once the settlement agreement is signed, it is too late to structure fees. Fortunately, the lawyer is not treated as earning a contingent fee until the settlement agreement is signed.

(Photo credit: Diacritical)

A primary goal is to save taxes. A structure impacts when the fees are taken into income and defers taxes on the investment earnings on those fees. Structured fees allow pre-tax investing, locking in pre-tax investment return.

Plus, there is virtually no risk the payments will not be made. The defendant pays a third party for the purchase of annuities benefiting the attorney. The leading tax case is *Childs v. Commissioner*.

In *Childs*, the defendant paid a third-party annuity provider. The IRS argued that the attorneys were entitled to their fees in cash so "constructively" received the payments. However, the Tax Court and the Eleventh Circuit Court of Appeals ruled that the settlement documents controlled. The IRS lost in *Childs* and has since given up on attacking structured legal fees.

The contingent fee agreement should specify that the lawyer can elect to structure fees at the conclusion of the case. However, if the fee agreement does not contain such a provision, the agreement can be amended. The lawyer, client and defendant can all agree that some of the lawyer's fee will be paid to an annuity issuer and the IRS will respect it.

If the lawyer practices in a firm, the firm is probably entitled to the fee. Thus, the law firm may implement the structure. More commonly, though, even if the plaintiff law firm is technically entitled to the legal fee, structured fee arrangements will be implemented for individual attorneys.

Plaintiff attorneys unfamiliar with legal fee structures should consider them. Few devices allow income earners to push off income into the future without running serious risk. Legal fee structures do just that, and only for lawyers.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.