Can Clients Save Taxes By "Partnership" With Lawyers?

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I. INTRODUCTION

The tax treatment of contingent attorneys' fees has engendered considerable controversy. Understandably, plaintiffs do not want to pay taxes on the portion of their recovery that their attorneys alone receive. A plaintiff who owes a one-third contingency to his lawyer expects to pay tax only on the two-thirds he gets to keep. To think otherwise seems almost un-American.

The very real possibility that a plaintiff will pay tax on fees he will never see has led to a variety of attempted end-runs around the tax problem. The goal is to make it more likely that the plaintiff will be taxed only on his net recovery. Most plaintiffs' attorneys arrange settlement checks so that the client never receives the lawyer's share of the settlement. Instead, the client receives only a net check.

Of course, taxes often do not hinge on physical receipt. In *Commissioner v. Banks*,[2] the Supreme Court held "as a general rule" that the full amount of the plaintiff's recovery, including contingent attorneys' fees, is gross income to the plaintiff. In the wake of this landmark case, many tax practitioners shifted their focus from whether the fees are gross income, to whether the attorneys' fees are tax deductible.

II. INCOME VS. DEDUCTION

If the legal fees are income to the plaintiff, as *Banks* says they generally are, one must address whether and how the fees are deductible. Deductions come in many guises. Shortly before the Supreme Court's *Banks* opinion, Congress amended §62 to allow plaintiffs to deduct attorneys' fees paid to pursue unlawful discrimination claims and certain claims against the government.[3]

This above-the-line deduction achieves the same economic effect as netting the fees: a complete wash. Moreover, many business taxpayers were already able to deduct attorneys' fees as ordinary and necessary business expenses.[4] Here, too, the result should generally be the same as netting the fees.

Nevertheless, a large category of attorneys' fees is caught by the general rule announced in *Banks*. If a plaintiff does not qualify for the statutory above-the-line deduction, and the legal fees were not paid or incurred in pursuing a trade or business, the income inclusion is a much bigger problem. Attorneys' fees that do not fit within these provisions may still be deductible as miscellaneous itemized deductions.[5] Yet all deductions were not created equal. Miscellaneous itemized deductions are far from equivalent to deductions above-the-line.

The discrimination to which miscellaneous itemized deductions are subject is threefold. First, miscellaneous itemized deductions are only deductible to the extent they exceed two percent of the taxpayer's adjusted gross income ("AGI").[6] Second, they may be limited by the itemized deduction phase out.[7] Third, they may increase the taxpayer's alternative minimum tax ("AMT") liability,[8] since legal expenses are non-deductible for purposes of the AMT.

Plaintiffs claiming attorneys' fees as miscellaneous itemized deductions even run the risk that the IRS may assert that the expenses are non-deductible personal expenses.[9] The federal income tax liability produced by the inclusion of contingent attorneys' fees can significantly reduce the plaintiff's recovery. In some cases, the federal income taxes due can actually exceed the plaintiff's net (post-attorneys' fees) recovery, so the plaintiff actually *loses* money by "winning" the case.[10]

Few persons looking at such a situation are likely to find it equitable. However, our tax system is highly complex and highly compartmentalized. Whether an item constitutes gross income to the plaintiff (e.g., the attorneys' fees) is entirely distinct from whether and how the plaintiff can deduct it.

The years leading up to the *Banks* case produced a veritable travesty of confusing and disparate tax treatment. There was a vitriolic and highly publicized split in the circuits.[11] There were five previous denials of *certiorari*, notwithstanding the customary rule that a split in the circuits merits a Supreme Court response.[12]

There was even public outcry over the respects in which this tax treatment undercut notions of fundamental fairness, and possibly even constitutionality.[13] When the Supreme Court finally did consider the issue in *Banks*, the Court had 18 *amicus* briefs before it. Yet, in a decision that was not the Court's finest hour, it announced only a "general rule," and expressly sidestepped several arguments contained in briefs for the taxpayers and the *amicus curiae*.[14]

Understandably, therefore, creative plaintiffs have advanced a number of arguments as to why *their* attorneys' fees should be outside the *Banks* rule. If the *Banks* case general rule is that legal fees are generally income for federal tax purposes,[15] surely some exceptions apply.

III. THE PARTNERSHIP THEORY

Can a plaintiff's financial relationship with his attorney be construed as a partnership rather than a contractual agreement to pay for services? Even if a "regular" contingent fee arrangement is not a partnership, can such a relationship be

affirmatively *structured* to be a partnership? In many joint ventures, the parties contribute assets and/or services. Surely a plaintiff could contribute his legal claim to a partnership, and the attorney could contribute his skill and effort.

If an attorney-client relationship is a partnership for federal income tax purposes, then any recovery should presumably be allocated to the partners in accordance with their respective interests in the partnership. A partnership is not a taxpaying entity. It allocates income and loss to its partners, who themselves pay tax. That means a plaintiff/client in partnership with a lawyer should arguably not recognize the attorneys' fee portion of the recovery as gross income, thus avoiding the limitations on miscellaneous itemized deductions.

Does this work in theory or in practice? If it does, how must it be implemented? In large part, these issues remain untested. In the years to come, they are likely to face scrutiny in a number of guises.

IV. ASSIGNMENT OF INCOME LORE

The courts created the assignment of income doctrine to prevent taxpayers from avoiding tax by transferring *income* to another person. It can even prevent one from assigning *property* to another person before the property produces income.[16] Put another way, this doctrine allows the courts to determine who actually *earned* income produced by property.[17] The courts have applied the assignment of income doctrine in various contexts, including the receipt of lease payments,[18] bond interest,[19] capital gains,[20] and recoveries pursuant to contingent attorneys' fee agreements.[21] There has long been debate about whether plaintiffs and their contingent-fee attorneys implicate the assignment of income doctrine.

To some, contingent attorneys' fee agreements readily fit the assignment of income problem. The legal claim itself may be seen as the underlying property, and the recovery may be viewed as the income eventually produced by the property. However, part of the difficulty in applying this concept involves determining whether a fee agreement should be considered to assign a portion of the plaintiffs' chose in action, or rather a portion of the recovery.

Another difficulty relates to the uncertainty of the recovery viewed at the outset of the litigation. One encounters significant factual variation, as lawyers are hired at different times and with different expectations. Yet, axiomatically, attorneys working under contingent-fee agreements do so on contingency, and risk receiving nothing.

Conversely, if there is a recovery, the plaintiff is indebted to the attorney according to the terms of the fee agreement. When a recovery occurs, the plaintiff has arguably transferred something of value to the attorney in satisfaction of his debt. A number of courts have considered these issues. Moreover, the *Banks* Court ultimately used the assignment of income doctrine as its rationale for taxing the plaintiff.

V. PARTNERSHIP VS. ASSIGNMENT OF INCOME

Only a few courts have considered the possibility that an attorney-client relationship could constitute a partnership avoiding the assignment of income doctrine. Some believe the assignment of income doctrine was created by the courts to curb abuses between family members, not unrelated persons.[22] Dealings between clients and their unrelated attorneys, who are licensed and regulated professionals, should arguably not be pulled within the assignment of income net.

In one Tax Court case, a dissenting Judge urged viewing a contingent attorneys' fee agreement as the joint ownership of property, or as analogous to a crop-sharing agreement between a tenant farmer and a landowner.[23] The tenant generally bears all of the direct and overhead expenses of the venture, and the landowner generally bears only the real estate carrying costs.[24]

Before *Banks* reached the Supreme Court, the Sixth Circuit ruled that the assignment of income doctrine did not apply to the attorneys' fee portion of the taxpayer's recovery.[25] The Sixth Circuit reasoned that the taxpayer's claim was like a partnership or joint venture to which the taxpayer assigned one-third of his claim, in hopes of recovering the other two-thirds.[26] The Supreme Court disagreed with the Sixth Circuit, holding the full amount of the plaintiff's recovery (including the contingent attorneys' fees) to be includable in the plaintiff's gross income.

The Supreme Court in *Banks* initially rejected "the suggestion to treat the attorney-client relationship as a sort of business partnership or joint venture for tax purposes."[27] The Court reasoned that the attorney-client relationship, "regardless of the variations in particular compensation agreements or the amount of skill and effort the attorney contributes, is a quintessential principal-agent relationship."[28] Although the client may not be able to reap value from his claim without the attorney's assistance, the Supreme Court saw that as the situation in any principal-agent relationship.

In the Supreme Court's view, the client retains ultimate control over the underlying claim to ultimately determine when and whether settle. Because the attorney is "duty bound to act only in the interest of the principal [the client],... it is appropriate to treat the full amount of the recovery as income to the principal."[29] However, only a few paragraphs later, the Court acknowledges the receipt of briefs from the respondents and *amicus curiae* that argued a "contingent-fee agreement establishes a Subchapter K partnership under 26 U.S.C. §§702, 704, and 761. . . ."[30] The opinion then states that the arguments contained in those briefs "it appears, are being presented for the first time into this Court."[31]

The Supreme Court therefore declined to entertain these "novel propositions of law with broad implications for the tax system that were not advanced in earlier stages of litigation and not examined by the Courts of Appeal."[32] The

following questions come to mind:

- If the suggestion that a contingent-fee arrangement establishes a partnership for federal income tax purposes is something the Supreme Court was declining to consider, why did its opinion (just a few paragraphs earlier) reject the possibility that Banks' attorney-client relationship could be a business partnership or joint venture?
- Was the Supreme Court making a subtle distinction?
- Was it suggesting that the fundamental attorney-client relationship (which focuses on privileged legal advice) is distinct from the contingent-fee arrangement to which attorney and client agree merely to facilitate *payment* for that legal advice? After all, if an attorney is faithfully performing his job in compliance with his professional and ethical duties, the substance of his legal advice to his client should not change by virtue of the fee arrangement.

However one tries to answer these questions, most observers believe the Supreme Court expressly declined to decide the partnership issue. Despite the one sentence rebuke of the partnership notion here, the Court does say it is declining to consider these issues. Interestingly, a perusal of some of the briefs of the respondents and *amicus curiae* in support of attorney-client partnerships reveals a focus on the fee arrangement between Banks and his attorneys, not the substantive legal advice he received.

One of the briefs argued that Banks' contingent-fee arrangement shifted "practical and legal control of the contingent-fee portion of the settlement proceeds from Mr. Banks to his attorney."[33] The brief espoused many theories why the arrangement constituted a partnership or joint venture. It argued that Banks had given up control of the attorneys' fee portion of his recovery, which had therefore become (essentially) a property right of his attorneys.[34]

Another amicus brief argued that the contingent-fee arrangement is a partnership because the attorney's services are critically important to adding value to the underlying claim, and both the attorney and client share the risk in the outcome of pursuing the asset.[35] In the same way that tax law distinguishes between partners and service providers, the "same result should obtain where the risk-taking partner is a lawyer working on a contingency fee basis."[36] These arguments, which the Supreme Court declined to consider, do not focus on the *substance* of the attorney-client relationship (the legal advice), but rather on the ownership of the underlying claim and/or fees associated with that arrangement.

VI. INTENT OF PARTIES

What constitutes a partnership? This question would seem to invite a simple and clear answer, particularly if one refines it, asking what constitutes a partnership *for federal income tax purposes*. Surprisingly, the answer is neither simple nor clear. To begin to address just what constitutes a partnership, one must venture down a historical path.

What constitutes a partnership for tax purposes historically occupied many volumes of authority. A mere summary of the area occupied many pages in a huge number of tax opinions and offering memoranda. Readers may remember that from the 1960s through the 1990s, many tax opinions covering tax issues such as various tax credits, passive activity losses, depreciation, amortization, and many other substantive tax issues, began first and foremost by discussing whether the vehicle was a partnership for federal income tax purposes.

In effect, the partnership is often the railroad that transports the substantive tax goods. Historically, the courts examined the parties' intent to determine whether a partnership was created pursuant to federal tax law.[37] Intent sounds inherently subjective. Yet in *Commissioner v. Culbertson*,[38] the Court established factors to consider in determining whether the parties intended to create a partnership.[39] These factors include:

- the agreement;
- the conduct of the parties in execution of its provisions;
- statements of the parties;
- the testimony of disinterested persons;
- the relationship of the parties;
- the respective abilities and capital contributions of the parties;
- the actual control of income and the purposes for which it is used; and
- any other facts throwing light on the parties' true intent.[40]

The courts have generally applied similar factors to determine whether a partnership was created pursuant to state law.[41] Given the history and import of this partnership determination, one would expect the authorities to be voluminous and well-defined, even when it comes to something specific, such as applying this fundamental question to attorney-client arrangements. Yet surprisingly, there is a paucity of case law. Indeed, the Tax Court has considered the merits of the attorney-client partnership argument in only several cases. In *Bagley v. Commissioner*,[42] and *Allum v. Commissioner*,[43] the taxpayers argued an attorney-client partnership to exclude attorneys' fees from their gross incomes. Neither taxpayer presented any significant evidence that he had intended to create a partnership with his attorney. In each case, the court applied the *Culbertson* intent factors to find that no partnership was created.

Intent, however, is not the only point of relevance. Going beyond intent requires going further afield into the nooks and crannies of partnership tax law.

VII. PARTNERSHIP DEFINITIONS

The Code includes guidelines about what constitutes a partnership, and they predate the case law considered here.[44] One general definition applies to the entire Code,[45] denominating a "partnership" as a "syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on … which is not … a trust or estate or a corporation."[46] The other definition applies specifically to Subchapter K, although its definition is essentially the same.[47]

The courts have said that "carried on" implies some business activity.[48] Indeed, the courts have said that business activity, not ownership of property, is decisive.[49] Yet, common sense would seem to dictate that the phrase "any business, financial operation, or venture" should include nearly *any* financial transaction. It is very broad.

Similarly, the phrase "which is not … a trust or estate or a corporation" is also expansive, suggesting that partnership classification is a true catch-all for all things that are not trusts, estates, or corporations.[50] These requirements set a low threshold for the creation of a partnership under federal income tax law.

Do these minimalist requirements for the existence of a partnership mean that an arrangement between lawyer and client should be included? In the few cases to consider the argument, the courts have not even applied these foundational definitions. This seems odd. Ethical issues aside (and that topic is addressed below), it does seem more than merely arguable that a plaintiff and attorney can forge a relationship sufficient to satisfy the Code's partnership definitions.

VIII. CHECK-THE-BOX REGULATIONS

After the substantial history of partnership nomenclature in our tax law, the rules changed radically in 1997. In that year, the Treasury Department issued final Regulations to eliminate many difficult entity classification issues.[51] These Regulations are often referred to as the "check-the-box" Regulations, signaling a change from amorphous facts and circumstances inquiries to a meant-to-be-idiot-proof one page multiple choice form. Significantly, these Regulations specify when a partnership has been created for purposes of federal income tax law.

The check-the-box Regulations depart from the body of established case law and, in some respects, depart even from the definition of a partnership provided in the Code. The check-the-box Regulations make it clear that federal tax law determines whether a separate partnership entity exists for tax purposes, and notably, this determination does not depend on whether the partnership is recognized under local law.[52] The linchpin for whether a partnership exists is whether individuals have teamed together for purposes of making and dividing profits.

For example, the check-the-box Regulations provide that merely carrying on a trade or business, financial operation, or venture and dividing the profits therefrom *can* be sufficient to create a separate entity for tax purposes.[53] Yet the mere sharing of expenses does not create a partnership,[54] nor does mere co-ownership of property "that is maintained, kept in repair, and rented or leased. . . ."[55]

However, if co-owners of a rental property also provide services to the occupants directly or through an agent, then a partnership has been formed.[56] The Regulations' view of what constitutes a partnership can encompass a wide range of financial arrangements.[57] For example, a mere contractual arrangement to divide profits can qualify as a partnership.[58] This conforms to prior case law.[59]

Moreover, the Regulations identify partnerships as entities that are not trusts, corporations pursuant to state or other law, or corporations pursuant to an election by the owners.[60] This language makes partnerships a default classification, being any business entity with at least two members that is not a trust or corporation.[61] A partnership results in most cases where there are two or more parties involved in a financial arrangement, and where the type of entity is not otherwise clear.[62]

An eligible domestic business entity with at least two members, which is not otherwise classified as a corporation, constitutes a partnership unless it elects to be treated as an association (and thus a corporation) for purposes of federal income tax.[63] For example, an LLC that does not elect otherwise is a partnership by default.[64] To elect to *not* be treated as a partnership, such entities should file a Form 8832. Otherwise, the default classification for such entities is a partnership.[65]

Every domestic partnership is to file a partnership return (Form 1065).[66] The required Form 1065 must be signed by at least one general partner (or managing member in the case of an LLC).[67] The form seeks information on the partnership's principal business activity, contact information, employee identification number, method of accounting, etc., but it is nothing particularly complex.[68]

Given the low threshold to constitute a partnership, there seems to be no reason (at least under federal income tax law) why a contingent attorneys' fee agreement could not qualify as a partnership pursuant to the check-the-box Regulations. Some plaintiff's attorneys may not wish to file a partnership return based on fears of negative consequences from the State Bar. It may be possible, however, for lawyer and client to individually include his share of partnership income, deductions, and credits on his personal return without filing a partnership return.

Failure to file a partnership return subjects a partnership to certain penalties, which are relatively minimal: $85 x the number of partners per month, but not to exceed 12

months.[69] A willful failure to file a partnership return can incur greater penalties.[70] Nevertheless, no penalty will be imposed for failure to file a partnership return if the partnership can show the failure was for reasonable cause.[71]

A "small partnership" is presumed to have reasonable cause for its failure to file a partnership return if (1) each partner has fully reported his share of income, deductions, credits on his timely filed income tax return; (2) the partnership consists of 10 or fewer partners who are either individuals (other than nonresident aliens), a C corporation, or an estate of a deceased partner; and (3) each partner's interest in the partnership items corresponds with his proportionate share of all other items.[72]

This reasonable cause exception would seem to cover a broad range of partnership arrangements between a contingent attorney and his client. Moreover, even if this reasonable cause exception is not met, the IRS has indicated that a small partnership may still be able to show reasonable cause for its failure to file a partnership return.[73]

IX. STATE LAWS

Federal, state, local, and foreign laws can all impact tax considerations. Generally, state laws grant property rights, and federal tax law determines the federal income tax implications of those rights.[74] Oddly enough, however, this appears not to be the case on the threshold question of whether a partnership *exists* for federal income tax purposes. Although state law plainly provides for the creation of partnerships, federal income tax law does not look to state law to determine whether a partnership has been created.[75]

The mere fact that you have a *state* law partnership does not mean you also have a partnership for federal income tax purposes. Conversely, even if you have a partnership for purposes of *federal* income tax law, it may not be recognized as such under state law. Several of the courts that have either explicitly or implicitly addressed the attorney-client partnership argument appear to have overlooked this important concept.[76] In *Banks*, the Supreme Court looked to state law to determine that the attorney-client relationship was that of a principal-agent.

The Court's reference to agency law may foreshadow the possibility that courts will (in my opinion erroneously) look to state law for the *existence* of a partnership. Indeed, in *Kenseth v. Commissioner*,[77] the Tax Court looked to state law to rule that an attorney-client relationship was that of a fiduciary and beneficiary, not a partnership. The *Kenseth* case was bitterly divided in the Tax Court, and was a reviewed opinion, so all available judges participated in the case.[78] Not only could the bevy of Tax Court judges not agree, they could not even agree whether state law or federal tax law should control.

In *Estate of Clarks v. United States*,[79] the Sixth Circuit looked to Michigan's attorney lien statute, finding that it created joint ownership of the claim equivalent to a partnership. Indeed, many of the cases preceding *Banks* considered state attorneys' lien laws in assessing federal income tax treatment.[80] Some states even considered amending their attorney lien laws as a paean to plaintiffs facing tax problems associated with attorneys' fees.[81]

The courts may have looked to state laws due to the way in which the partnership argument was presented. Courts have generally considered this argument in the context of the assignment of income doctrine and state statutory fee shifting laws. The courts focused primary attention on these arguments, commenting only in passing on the possibility that an attorney-client relationship might constitute a partnership for tax purposes.

X. ATTORNEYS' RULES OF PROFESSIONAL CONDUCT

One of the great areas of confusion relates to the rules of professional ethics, and how these rules impact a putative partnership between lawyer and client. Can you do it, and if so, how? Just as state law does not dictate whether a partnership is created for purposes of federal tax law, the professional rules of conduct for attorneys should not do so either.[82]

By their very terms, such rules do not govern the substantive rights of the attorney or the client.[83] Moreover, historic federal partnership tax law suggests that federal tax rules trump everything, codes of professional conduct included. The professional conduct rules are largely disciplinary rules for attorneys.[84] An attorney who violates them may be subject to discipline. States exercise this power to regulate the profession, and to protect the public.

Although the courts may use these rules to void contractual agreements between attorneys and clients,[85] a partnership between lawyer and client (for federal income tax purposes or otherwise) should not be prejudiced. Indeed, this seems especially true where a partnership (at least for federal income tax purposes) was created (mostly or wholly) for the federal income tax *benefit* of the *client*. If the client asks the attorney to recast what would otherwise be the lawyer's boilerplate one-third contingent-fee agreement into a two-thirds and one-third "partnership agreement," has the client been damaged? From a tax perspective, the answer is clearly no.

Indeed, the taxpayer may have *benefited* materially. Of course, rules of professional conduct can prevent attorneys from entering into certain arrangements with clients. They can also require the attorney to withdraw from representation. Clearly, these issues should be considered by an attorney prior to entering into an attorney-client partnership.

The attorney surely should protect his law license too. However, such issues should have no relevance in determining whether a partnership exists for federal income tax purposes. In fact, courts that have considered an attorney-

client partnership for tax purposes seem to *assume* that the rules of professional conduct for attorneys actually *prohibit* attorneys from entering into partnerships with clients for *all* purposes.[86]

Attorneys should check their own state rules, but the "no partnership" assumption may be incorrect.[87] To begin with, the state bar surely has no reason to prohibit partnerships for *federal income tax purposes*, even if a partnership under state law is verboten. Often, however, a close look at the bar rules will reveal that there is no outright prohibition on a lawyer-client partnership even for purposes of state law.

Instead, the rules may contain express disclosure requirements which the attorney must observe when entering into a business transaction with a client.[88] These rules generally provide that the transaction or acquisition must be fair and reasonable to the client. They may also require the attorney to advise the client in writing to seek independent counsel to review the transaction or acquisition. The client may also have to consent in writing to the terms of the transaction or acquisition.[89]

Some concern is also voiced over attorney fee splitting rules.[90] The rules of professional conduct prohibit attorneys from splitting legal fees with non-lawyers.[91] If the partnership is to practice law, the attorney may be found to have impermissibly split legal fees with a non-lawyer.[92] Yet surely, the lawyer-client partnership is not what those rules were designed to address.

In fact, those rules were presumably intended to prevent non-attorneys who have entered into a partnership with an attorney from providing legal advice to clients who are *not* members of the partnership. Those rules should not be interpreted to prevent an attorney from establishing a partnership with his own client (especially for the sole tax benefit of the client). If the client knowingly and willingly agrees to a partnership, and the client does so to derive tax benefits, how could this be prohibited?

Indeed, if a partnership (recognized at least for federal income tax purposes) consists solely of the attorney and the plaintiff, it would be difficult to argue that the attorney is helping (or allowing) the plaintiff/client to practice law. That same plaintiff would not be viewed as practicing law with respect to his *own* claim, for plaintiffs can represent themselves in *pro per*. An attorney helping a plaintiff to represent himself presumably does not violate professional rules of conduct.

XI. CONTROL OF THE CASE

Another ethical sticky wicket relates to control over settlement authority and other decision-making. State bar rules may prohibit an attorney from depriving the client of the power and authority to decide whether and for how much to settle. Even if the attorney stands to make one-third or more on the case, it is the client's decision. This control factor may be a fundamental stumbling block on which courts may reject the attorney-client partnership theory.

For example, prior to *Banks*, Judge Posner of the Seventh Circuit (in affirming *Kenseth*) eviscerated *Kenseth's* argument that he had given up control of his claim (an income producing asset) to his attorney. Judge Posner pointed out that regardless of whether Kenseth's attorney worked for a contingent or fixed fee, Kenseth had not relinquished control because he retained the right to fire his attorney.[93] The Supreme Court in *Banks* seemed to hinge its decision, at least in part, on the fact that Banks had retained ultimate dominion and control over the underlying claim.[94]

In *Allum*, the Tax Court cited *Banks* extensively in rejecting an attorney-client partnership, noting that the taxpayer in *Banks* had not given up control of his underlying claim.[95] In rejecting the taxpayer's *de facto* partnership theory in *Allum*, the Tax Court noted that the taxpayer did not view his attorney "as a coowner of his legal claims, but rather, as a legal representative receiving compensation for his services."[96]

Yet surely, the presence or absence of a partnership on this point should be irrelevant. A partnership can allocate decision-making responsibility and authority. Whatever share of partnership income may accrue to a lawyer-partner, the client-partner may retain all of the decision-making power in the case. Optimally, that should be done in a written partnership agreement.

However, since partnership agreements can clearly be oral, it is by no means clear that such points must be in writing. From a federal income tax perspective, such allocation of responsibility and authority should be irrelevant, except perhaps as an indicator of intent. If the bar queries who has the power to settle 100% of the case, lawyer and client will presumably agree that the *client* does, whether or not the writings so state.

XII.BARRATRY, MAINTENANCE, AND CHAMPERTY?

Contingent-fee arrangements and attorney-client partnerships may also warrant a discussion of the common law concepts of barratry, maintenance, and champerty. At common law, barratry was a misdemeanor criminal offense resulting when a person excited or stirred up lawsuits or quarrels.[97] Maintenance and champerty were offenses resulting where a stranger to the lawsuit made a deal to assist a litigant by aiding in finance (maintenance) in exchange for a portion of the proceeds (champerty).[98]

Courts in the United States have generally rejected or abandoned the vague common law concepts of maintenance and champerty, although some retain a prohibition against barratry.[99] If this were not so, virtually any contingent-fee arrangement could run afoul of maintenance and/or champerty rules. The vestiges of barratry today take the form of state-defined rules against barratry, solicitation, and/or malicious prosecution.[100]

The overarching goal of such rules is to prohibit an other-

wise disinterested third party promoter from stirring up litigation that benefits him personally, as opposed to benefiting the litigant or the public.[101] Contingent-fee arrangements have co-existed with these barratry-like prohibitions for decades. An attorney-client partnership should raise no greater risk of engaging in barratry than that which already exists.

XIII. CONFLICTS OF INTEREST

Another question is whether an attorney-client partnership to recover on an underlying claim would violate conflict of interest rules. The rules of professional conduct require attorneys to avoid conflicts of interest.[102] When the attorney represents an organization such as a partnership, the *organization* is considered the client.[103] The attorney's duty is to the organization, not its directors, officers, employees, partners, members, shareholders, or other constituents.[104]

If a lawyer-client partnership would result in the client losing the ability to terminate the attorneys' services, engage another attorney, or decide when to compromise the claim, conflict of interest rules could conceivably be advanced as stumbling blocks to a partnership.[105] Yet, partnerships are extraordinarily flexible arrangements that can be structured to avoid these issues. Moreover, if state law or ethics rules created some insuperable barrier to a true state law sanctioned partnership (which I doubt), then we must return to the question of which law controls.

Recall that our sole objective here – for the sole benefit of the plaintiff/client who may otherwise face an inequitable tax burden – is to form a partnership for purposes of federal income tax law. A financial arrangement between lawyer and client may not rise to the level of a partnership under pertinent state law, even though a partnership is deemed to exist for purposes of federal income tax law. In fact, maybe that is an *optimal* design. If the partnership is recognized as a partnership only for purposes of federal income tax law, there may be no need to look to the state attorney professional conduct rules.

However, other ethical considerations may actually suggest that the attorney has a *duty* to explore the partnership form. Consider that for tax purposes, the attorney-client partnership benefits only the client, not the attorney. After all, the amount the attorney receives will clearly constitute income regardless of whether the attorney receives fees from the client (after the client includes them in his own income) or as part of the profits of a partnership.

Given the fiduciary and ethical concerns, the attorney may be averse to what he sees as the slippery slope of a partnership with his client, even though it is in the client's best interest. Yet, if such an arrangement is possible, then isn't it conceivable that the attorney may have a duty to try to effectuate it?

XIV. PLANNING THE ATTORNEY-CLIENT PARTNERSHIP

It is rare for plaintiffs and their counsel to consider tax issues when they formalize their relationship in a fee agreement and when they file a complaint. Any tax planning and tax projections usually are done as settlement offers are being considered. In fact, tax planning is often considered for the first time *after* the plaintiff receives his recovery, or even in the next calendar year at tax return time.

Clearly, the optimal time to address these issues is when the lawyer-client relationship is commenced. However, even an amendment to a fee agreement right before settlement, a clarification of what lawyer and client intended by their joint venture, may be enough to change the tax result. With planning from the beginning of the attorney-client relationship, or at the latest, before the case is completed (after all, the attorney arguably doesn't earn his fee under a fee agreement until legal rights are released), a partnership (for federal income tax purposes) may be achievable.

One avenue is presumably for a plaintiff and attorney to enter into a formal partnership agreement under state law. Even if attorney-client partnerships are flatly prohibited by some state laws, it is worth questioning whether that prohibition is a feature of the partnership law (unlikely), or rather is a dictate of state bar rules. Moreover, it may be possible to craft a legal fee agreement that looks like a partnership agreement, or to craft a partnership agreement that looks like a fee agreement. The economics and control issues should not be difficult to address.

If it is unclear whether the attorney is committing an ethical violation by agreeing to cast his relationship with his client as a partnership, a savings clause in the agreement may prevent violation. For example, the agreement may provide that "notwithstanding anything herein to the contrary, this agreement shall be interpreted as a partnership between lawyer and client only to the extent permitted by law."

Whether one wants to try to make a fee agreement partnership-like in character, or to opt more in favor of a "real" partnership agreement, involves a judgment call. There may be no need to adopt a partnership-or-bust mantra. After all, the threshold under federal income tax law for what constitutes a partnership seems to be low.

A number of variables in formation are possible. Some practitioners may want the plaintiff to contribute his claim to the partnership. The client, attorney, or both could contribute funds to the partnership to cover the costs to prosecute the claim. If the partnership was formed prior to the claim being filed, the partnership might itself be a plaintiff. Otherwise, the partnership may simply own all or a portion of the claim the plaintiff contributed to it, though the case proceeds solely in the plaintiff's name.

A partnership agreement could include many of the standard terms the attorney would otherwise include in his fee

agreement. The attorney should consider the language on withdrawing from representation, conflicts of interest, and the manner in which fees, costs, and recoveries are allocated between partners. The income or loss associated with prosecuting the claim would flow through to the partners in accordance with the terms of the partnership agreement.

Such an arrangement should satisfy most, if not all, of the *Culbertson* intent factors,[106] the partnership definition in the Code, and even the check-the-box Regulations. Whatever the applicable state bar rules say about such an arrangement, it may be hard to argue that such an arrangement should not be respected for federal income tax purposes.

XV. ASSIGNING PORTION OF CLAIM TO ATTORNEY

Rather than contributing his claim to a partnership, a plaintiff could assign a portion of his claim directly to his attorney. Such an assignment may create a partnership solely for purposes of federal income tax law, or could conceivably avoid the partnership altogether. If the attorney accepts a share of an inchoate claim in exchange for an agreement to pursue that share (the client riding along on his coattails), perhaps each person is taxed separately on a recovery without the need for partnership analysis. Plaintiffs can generally assign legal claims to third parties, and they should not be subject to federal income tax on the assignment if the assignment is made at a time when the recovery is inchoate or uncertain.[107]

The agreement used to assign all or a portion of the claim to the attorney could include many of the terms contained in the attorney's standard fee agreement. Such an "assignment agreement" could perhaps be in lieu of a formal partnership agreement. Under the assignment of income doctrine, one question would be whether the claim was assigned to the attorney when the claim was uncertain or inchoate.

Yet, if the claim was inchoate when it was assigned, the respective owners should presumably each report and pay tax on the portion attributable to their ownership interest when the recovery later accrues. Unless the assignment is made on the eve of settlement when the value of the case is arguably certain, such an assignment should be respected. However, a note of caution comes from the Court of Appeals for the Federal Circuit, which addressed this type of arrangement in *Baylin v. United States*.[108]

In *Baylin*, an employer assigned a portion of its claim to its in-house attorney.[109] The attorney prosecuted the claim and obtained a recovery.[110] The IRS considered the attorneys' fees to be a capital expenditure by the partnership, which reduced the partnership's capital gain.[111] The court said that even though:

> "the partnership assigned a portion of its … recovery to its attorney before it knew the exact amount of the recovery does not mean that this amount never belonged to the partnership; it means simply that the attorney and client chose to estimate the value of the attorney's services by tying the fee to the ultimate recovery and by having the obligation of the client to the attorney discharged by having the state pay the attorney his fees directly from the recovery. The temporarily uncertain magnitude of the legal fees under such an arrangement and the vehicle of an assignment cannot dictate the income tax treatment of those fees."[112]

Interestingly, the *Baylin* case does not square with most of the other cases exploring the assignment of income doctrine. The case law has generally concluded that assigning assets to third parties at a time when the income therefrom is uncertain will result in the income being eventually taxed to the assignee, not to the assignor.[113]

An arrangement similar to the one considered in *Baylin* may well satisfy the Code's partnership definition and the check-the-box Regulations, although it is certainly disturbing that the IRS and the court did not agree. The parties could presumably increase the odds that the IRS or the courts would recognize this arrangement as a partnership by establishing that the *Culbertson* intent factors were satisfied.

Many of the perceived impediments to an attorney-client partnership stem from the perceived fiduciary and ethical hurdles this arrangement could create. As discussed above, ethical rules may prevent a client from giving an attorney partial control over his claim. Such rules may also prevent a partnership between attorney and non-attorney that involves the practice of law, and may prevent perceived conflicts of interest, etc. Even so, none of those barriers should prevent a partnership of lawyer and client for federal income tax purposes.

Nevertheless, for those fearing impediments to a partnership arrangement, a partial sale of a claim could perhaps provide an alternative. To me, however, the partnership model is easier, cleaner, and preferable in many respects to some kind of sale contract model.

XVI. RELEVANCE OF ATTORNEY FEE AGREEMENT

Can one have a partnership for federal income tax purposes even though the document signed by lawyer and client is entitled a "Fee Agreement?" Such a question may invoke substance vs. form inquiries. The most common way to embody an attorney-client relationship is in an attorney fee agreement. According to the Tax Court in *Allum*, a standard fee agreement alone will generally not qualify as a partnership for purposes of federal income tax law.[114] That is not surprising, in view of the complete lack of partnership-like criteria (or intent) present on *Allum's* facts.

Nevertheless, the courts might recognize a fee agreement as a partnership agreement if the fee agreement (and the parties' conduct) indicated that they *intended* to create a partnership.

It may be enough for the contingent-fee agreement to include language specifying that "the parties intend this Agreement to constitute a partnership for federal income tax purposes, and to constitute a partnership for all other purposes to the maximum extent allowed by law." This, along with complying with other business formalities, may be enough to satisfy the Code's partnership definition, the check-the-box Regulations, and the *Culbertson* intent factors.

Even with a regular fee agreement with perhaps one sentence devoted to the partnership idea, can (or should) a check-the-box form be filed? Since the check-the-box Regulations permit contractual arrangements to be cast as partnerships, there should be no problem with the permissibility of such an act. Whether it is a good idea may be debated, but there seems little downside to filing it (especially in situations where the contemplated attorney-client partnership may not meet the reasonable cause exception to partnership return filing requirements).

Will the lawyer-client partnership want to obtain an EIN and file partnership tax returns? Perhaps, but these points can be debated. It is possible for a partnership to be recognized for federal income tax purposes, even if that partnership has not filed a Form 1065.[115] In *S.O. Clagget, Liquidating Trustee for S.O. Claggett, Inc.*,[116] the Tax Court squarely addressed the question whether an agreement affected a contractual relationship or rather a partnership. The tax issue involved personal holding company issues, not the tax treatment of attorneys' fees. Yet, the Court addressed the sum and substance of the arrangement, and despite the lack of partnership tax returns, found a partnership for federal income tax purposes.

Of course, the more such steps lawyer and client take, the more secure the plaintiff may feel that he will not be attributed the lawyer's share of the income on the resolution of the case. On the other hand, to satisfy the minimal threshold for what constitutes a partnership, it may not be necessary to take such steps. We really don't have a litmus test for what is sufficient. We know the taxpayer in *Allum* had nothing going for him.

In *Allum*, the Tax Court's list of partnership-like actions showing the intent to create a partnership is essentially the same as the list from *Culbertson*:

- the agreement;
- the conduct of the parties in execution of its provisions;
- statements of the parties;
- the testimony of disinterested persons;
- the relationship of the parties;
- the respective abilities and capital contributions of the parties;
- the actual control of income and the purposes for which it is used; and
- any other facts throwing light on the parties' true intent.[117]

In *Allum*, the Tax Court also cited to another Tax Court case, *Luna v. Commissioner*[118], for additional partnership factors, including the following:

- whether each party was a principal and co-proprietor;
- whether one party was the agent or employee of the other, receiving for his services contingent compensation in the form of a percentage of income, (which is a factor against a partnership determination);
- whether the parties filed Federal partnership returns or otherwise represented to respondent or to persons with whom they dealt that they were joint venturers; and
- whether the parties exercised mutual control over and assumed mutual responsibilities for the enterprise.[119]

Plainly, one need not satisfy all such criteria. Moreover, it is difficult to rate the relative importance of each, as none of them is conclusive. Whether the parties *intended* a partnership "is a question of fact, to be determined from testimony disclosed by their agreement, considered as a whole, and by their conduct in execution of its provisions."[120] In *Allum*, not one single factor tending to establish the existence of a partnership was satisfied, leading the Tax Court to an easy conclusion that there was simply no partnership in that case.

Some practitioners may read *Allum* as setting the bar very high for what constitutes a partnership in this context. Such a reading is erroneous, in my opinion. *Allum* only stands for the proposition that there are *many* partnership indices, and Mr. Allum had not satisfied his evidentiary burden to meet even one of them. That should leave plenty of room for practitioners to do a little more planning, and to achieve partnership tax treatment, even if they fail many of the *Allum* criteria.

XVII. CONCLUSION

The courts have yet to fully consider whether an attorney-client partnership can be created, so the plaintiff can avoid gross income on the portion of a recovery his attorney receives. The Supreme Court in *Banks* failed to fully consider this question. Given the language of the Code regarding what constitutes a partnership, the case law, and the check-the-box Regulations, it should be possible for such an arrangement to accomplish this goal.

Indeed, I believe the only debatable issue is exactly how much one needs to do to invoke partnership tax treatment. Intent is important. Timing is, too. There are a host of actions one might take to bolster what might be seen as a partnership in name only. The stakes can be high, and the IRS is likely to be hostile to what it may perceive as sticking a square partnership peg in a round contingent-fee agreement hole. Thus, the more steps one takes, the better one may feel.

In reflecting on how much is enough, practitioners may wish to consider:

- executing a written partnership agreement;
- keeping books that reflect the partnership's allocations of contributions and distributions;
- filing a statement of partnership with the county recorder, Secretary of State, or other office under state law;
- filing a dba form;
- obtaining an EIN;
- filing a check-the-box form; and
- filing partnership tax returns.

These actions may all solidify a partnership position that, without at least some of these items, may appear to be a bootstrap. Yet I still do not believe most of those steps are necessary. They may be wise, and *Allum's* litany of partnership traits may make overachievers want to satisfy every point. From a tax perspective, there is surely nothing wrong with that.

However, an Olympic performance does not seem necessary when the hurdle to achieving partnership tax treatment appears to be more in the elementary school gym class arena. The IRS and the courts will eventually have to face the question of just how much is enough for partnership tax treatment, to allow lawyer and client to simply be taxable only on their personal shares. In the interim, plaintiffs and their attorneys should consider the range of possibilities this type of arrangement may offer, particularly in cases where the taxpayer would not otherwise be able to obtain a full tax deduction for his attorneys' fees.

Finally, how much lawyer and client are willing to do may also hinge at least in part on what other exceptions from *Banks'* general rule may be available. The client may have arguments that the fee paid to his lawyer is a statutory fee, outside *Banks'* general rule, and represents the sole property of the lawyer. The client may also have arguments that the legal fees (if gross income to the client) arise out of a trade or business, and thus could be netted against a recovery on the client's Schedule C. The client may even have arguments that his recovery is capital rather than ordinary, thus offering the possibility that related legal fees could be offset against such a recovery on the client's Schedule D.

All such issues are likely to be considered in assessing the merits of and need for a lawyer-client partnership.

ENDNOTES

1. Robert W. Wood practices law with Wood & Porter, San Francisco (www.woodporter.com), and is the author of *Taxation of Damage Awards and Settlement Payments* (3d Ed. Tax Institute 2005 with 2008 update), and *Legal Guide to Independent Contractor Status* (4th Ed. Tax Institute 2007), both available at www.taxinstitute.com. This discussion is not intended as legal advice, and cannot be relied on for any purpose without the services of a qualified professional.

2. *Comm'r v. Banks*, 543 U.S. 426 (2005).

3. IRC §62(a)(20), (e).

4. IRC §162.

5. IRC §67(a).

6. *Id.*

7. IRC §68.

8. IRC §56(b)(1)(A)(i).

9. IRC §262.

10. *See Spina v. Forest Preserve District of Cook County*, 207 F. Supp. 2d 764 (N.D. III. 2002).

11. *See* Wood, *Taxation of Contingent Attorneys' Fees Altered by the Jobs Act and the Supreme Court*, Chapter 4, Vol. 1, 57th Annual Tax Inst., USC Law School, 2005 Tax Inst..

12. *See* Wood, *Will the IRS Pursue Attorney Fees Post-Banks?* Vol. 108, No. 4, Tax Notes (July 8, 2005) p. 319.

13. For example, see 2002 National Taxpayer Advocate Report to Congress, at 166.

14. For example, the Supreme Court declined to consider the suggestion in a brief that a "contingent-fee agreement establishes a Subchapter K partnership" on the basis that it was one of many arguments "being presented for the first time to this Court," which had not been presented at the trial or appellate court level. *Comm'r v. Banks*, 543 U.S. 426, 437-438 (2005).

15. The taxpayer and amicus briefs submitted in *Banks*, advanced a number of different arguments, including the notions that litigation recoveries are: (1) proceeds from the disposition of property: (2) capital expenses that reduce capital gains; and (3) governed by to statutory fee shifting provisions where a court pays the attorney directly independent of any relationship between the attorney and client.

16. *Horst v. Comm'r*, 311 U.S. 112 (1940).

17. *Id.*

18. *Hort v. Comm'r*, 336 F.2d 701 (9th Cir. 1964).

19. *Helvering v. Horst*, 311 U.S. 112 (1940).

20. *Salvatore v. Comm'r*, 434 F.2d 600 (2d Cir. 1970).

21. *See Banks*, 543 U.S. 426 (2005).
22. The dissent in *Kenseth* supports the idea that the assignment of income doctrine should be primarily concerned with intra-family transfers. *Kenseth v. Comm'r*, 114 T.C. 399, 441-442 (2000) (Beghe, J., dissenting) *majority opinion aff'd*, 259 F.3d 881 (7th Cir. 2001). This idea was also alluded to, although not expressly spelled out, in *Estate of Clarks v. United States*, 202 F.3d 854, 856-858 (6th Cir. 2000), *overruled in part by Comm'r v. Banks,* 543 U.S. 426, 431 (2005). Restricting the assignment of income doctrine to family members is not favored by all. For example, in Stephen B. Cohen, *Missassigning Income: The Supreme Court and Attorneys' Fees*, 25 Va. Tax Rev. 415, 434 (2005), the article quotes oral arguments before the Supreme Court in *Banks*, which reject the idea that the assignment of income doctrine should apply only to family members.

23. *See* dissent of Judge Beghe in *Kenseth*, 114 T.C. 399 (2000), *aff'd*, 259 F.3d 881 (7th Cir. 2001).

24. *Id*.

25. *Estate of Clarks v. U.S.*, 202 F.3d 854 (6th Cir. 2000).

26. *Banks v. Comm'r*, 345 F.3d 373, 385-386 (6th Cir. 2003).

27. *Banks*, 543 U.S. at 436.

28. *U.S. v. Banks,* 543 U.S. 426, 436 (2005).

29. *Id*.

30. *Id* at 437.

31. *Id*.

32. *Id*.

33. Brief for the Respondent, 2004 U.S. S. Ct. Briefs Lexis 512, **24-26

34. Brief for the Respondent, 2004 U.S. S. Ct. Briefs Lexis 512, **27-31.

35. Brief for Amicus Curiae Taxpayers against Fraud Education Fund in Support of Respondents, 2004 U.S. S. Ct. Briefs Lexis 514, **10-16.

36. Brief for Amicus Curiae Taxpayers against Fraud Education Fund in Support of Respondents, 2004 U.S. S. Ct. Briefs Lexis 514, **16.

37. *Comm'r v. Culbertson*, 337 U.S. 733 (1949); *Comm'r v. Tower*, 327 U.S. 280 (1946).
38. *Comm'r v. Culbertson*, 337 U.S. 733 (1949).

39. *Id*.

40. *See* also *Allum v. Comm'r*, T.C. Memo 2005-177 (2005), *aff'd,* 231 F. Appx. 550 (9th Cir. 2007) (which cites the partnership factors in *Culbertson*).

41. For example, California law provides that the elements of a joint venture or partnership are (1) a community of interest in the subject of the undertaking; (2) a sharing in profits and losses; (3) an "equal right" or a "right in some measure" to direct and control the conduct of each other and of the enterprise; and (4) a fiduciary relation between or among the parties. See, e.g., *Stilwell v. Trutanich*, 178 Cal. App. 2d 614, 618-619 (Cal. App. 2d Dist. 1960).

42. *Bagley v. Comm'r*, 105 T.C. 396 (1995).

43. *Allum v. Comm'r*, T.C. Memo 2005-177 (2005).

44. The foundational definitions in IRC §7701 were added to the Code in 1959.

45. IRC §7701(a)(2).

46. *Id*.

47. IRC §761(a).

48. *Moline Properties, Inc. v. Comm'r*, 319 U.S. 436, 441 (U.S. 1943).

49. *Tomlinson v. Miles*, 316 F.2d 710, 714 (5th Cir. 1963).

50. McKee, Nelson, & Whitmire, *Federal Taxation of Partnerships and Partners*, §3.02[1] (4th ed. 2007).

51. Treas. Reg. §301.7701-1.

52. Treas. Reg. §301.7701-1(a)(1).

53. Treas. Reg. §301.7701-1(a)(2).

54. Treas. Reg. §301.7701-1(a)(2).

55. Treas. Reg. §301.7701-1(a)(2).

56. Treas. Reg. §301.7701-1(a)(2).

57. *Id*.

58. *Id*.

59. *See*, e.g., *Meehan v. Valentine,* 145 U.S. 611 (1892) (a Supreme Court case that's over 100 years old, yet which still appears to be good law, which commented that "it appears to be settled that the written contract entitling Perry to a share of the net profits, at least, makes out a prima facie case of partnership. . . ."); see also *Hanson v. Birmingham*, 92 F. Supp. 33, 42 (D. Iowa 1950) ("A partnership is contractual in nature, a contract being essential to the formation of a partnership").

60. Treas. Reg. §301.7701-2(a), (b), (c)(1).

61. Treas. Reg. §301.7701-2(a), (c)(1).

62. Treas. Reg. §301.7701-3(a), (b)(1).

63. Treas. Reg. §301.7701-3(a), (b)(1)(i); see also *People Place Auto Hand Carwash, LLC v. Comm'r*, 126 T.C. 359, 364 (2006).

64. *See People Place Auto Hand Carwash, LLC v. Comm'r*, 126 T.C. 359, 364 (2006). Similarly, an eligible foreign entity with two or more members (with at least one member that does not have limited liability, and which does not elect otherwise) is also treated as a partnership. Treas. Reg. §301.7701-3(b)(2)(i)(A).

65. *See Form 8832 (Rev. March 2007)*, available at www.irs.gov.

66. IRC §6031; Treas. Reg. §1.6031(a)-1(a); *2007 Instructions for Form 1065*, available at www.irs.gov.

67. *See 2007 Instructions for Form 1065*, available at www.irs.gov.

68. *See 2007 Form 1065*, available at www.irs.gov.

69. IRC §6698(a), (b), (c).

70. IRC §7203.

71. IRC §6698(a).

72. Rev. Proc. 84-35, 1984-1 C.B. 509; S.C.A. 200135029, 2001 SCA Lexis 12; 2-15 *Tax Planning for Partners, Partnerships, and LLCs* §15.05 (Matthew Bender 2008); Alan J. Tarr & Pamela Jensen Drucker, *Civil Tax Penalties* andA-10 (BNA Tax Management Portfolios 2005).

73. Rev. Proc. 84-35, §3.03.

74. *United States v. Craft*, 535 U.S. 274 (2002); see also *U.S. v. Rodgers*, 461 U.S. 677, 683 (1983).

75. *Comm'r v. Tower*, 327 U.S. 280, 288 (1946), *Nichols v. Comm'r*, 32 T.C. 1322, 1330 (1959), Cite for the Reg.

76. Stephen B. Cohen, *Misassigning Income: the Supreme Court and Attorneys Fees*, 100 Tax Notes 355 (Jan. 23, 2006); see also *Young v. Comm'r*, 240 F.3d 369, 378 (4th Cir. 2001).

77. *Kenseth*, 114 T.C. 399 (2000), *aff'd*, 259 F.3d 881 (7th Cir. 2001).

78. The "reviewed by the court" process is rare with Tax Court cases and limited to exceptional circumstances. See discussion on page 14 of the Reply Brief for Petitioners submitted to the United Supreme Court in *Kanter v. Comm'r,* No. 03-1034, available at http://supreme.lp.findlaw.com/supreme_court/briefs/03-1034/03-1034.mer.pet.rep.pdf.

79. *Estate of Clarks*, 202 F.3d 854 (6th Cir. 2000).

80. *See Cotnam v. Comm'r*, 263 F.2d 119 (5th Cir. 1959); see also cases collected in Wood, *Taxation of Contingent Attorneys' Fees Altered by the Jobs Act and the Supreme Court*, Chap. 4, Vol. 1, Fifty-Seventh Annual Tax Institute, USC Law School (2005).

81. *See* Wood, *Washington's Attorney Lien Law*, The Tax Adviser (December 2004), p. 729.

82. *See* Model Rules of Prof'l Conduct Preamble.

83. *Id.*

84. *Id.*

85. *See*, e.g., *Grausz v. Farber*, 2002 Cal. App. Unpub. LEXIS 6091 (Cal. App. 1st Dist. 2002).

86. For example, based on the fiduciary relationship between an attorney and his client, the Tax Court in *Kenseth* commented that it "is difficult, in theory or fact, to convert that relationship into a joint venture or partnership." *Kenseth*, 114 T.C. 399, 413 (2000), *aff'd*, 259 F.3d 881 (7th Cir. 2001). Even Judge Beghe in his heart-felt dissent concluded that "local laws and ethical rules prohibiting the assignment of claims to attorneys would be obstacles to the making of the capital contribution that is the prerequisite to the formation of a partnership." *Kenseth,* 114 T.C. at 454 (Beghe J., dissenting).

87. Comment to Rule 1-310 Calif.; cf. Model Rules of Prof'l Conduct R. 1.8(i).

88. Rule 3-300 – Calif.; Rule 1.08 – Texas.

89. *Id.*

90. *See*, e.g., *Polland & Cook v. Lehmann*, 832 S.W.2d 729, 735 (1992).

91. *See* Rules 2-200, 1-320 – Calif.

92. *See*, e.g., Rule 1-310 – Calif.; San Diego County Bar Association, Ethics Opinion 1984-1.

93. *Kenseth v. Comm'r*, 259 F.3d 881, 884 (2001).

94. *Banks,* 543 U.S. at 436.

95. *Allum*, T.C. Memo 2005-117, *27.

96. *Allum*, T.C. Memo 2005-117, *34.

97. *Rubin v. Green,* 4 Cal. 4th 1187, 1190 (1993).

98. *See*, e.g., *Son v. Margolius, Mallios, Davis, Rider & Tomar*, 709 A.2d 112, 120 (Md. 1998); *Abbott Ford v. Sup. Ct.*, 43 Cal. 3d 858, 885 n.26 (1987).

99. *See Abbott Ford v. Sup. Ct.*, 43 Cal. 3d 858, 885 n.26 (1987); *Accrued Fin. Servs. v. Prime Retail, Inc.*, 298 F.3d 291, 299 (4th Cir. Md. 2002).

100. *See*, e.g., *Accrued Fin. Servs. v. Prime Retail, Inc.*, 298 F.3d 291, 299 (4th Cir. Md. 2002); *Crowley v. Katleman*, 8 Cal. 4th 666, 694 (Cal. 1994); *Drum v. Bleau, Fox & Associates*, 107 Cal. App. 4th 1009, 1025 (2003).

101. *See Accrued Fin. Servs. v. Prime Retail, Inc.*, 298 F.3d 291, 299 (4th Cir. Md. 2002).

102. Model Rules of Prof'l Conduct R. 1.7.

103. Model Rules of Prof'l Conduct R. 1.13. Rule 3600 – Calif. The State Bar of California, Standing Committee on Professional Responsibility and Conduct, Formal Opinion No. 1994-137.

104. *Id.*

105. Cf. *Kenseth*, 114 T.C. at 414-415 (noting that under Wisconsin law the client retained the ability to settle his claims and that it would be an "ethical violation" for an attorney to press on with a client's claim against that client's will).

106. *Comm'r v. Culbertson*, 337 U.S. 733 1949.

107. *See*, e.g., *Schulze v. Comm'r*, T.C. Memo 1983-263.

108. *Baylin v. United States,* 43 F.3d 1451, 1455 (Fed. Cir. 1995).

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

113. *See*, e.g., *Baylin v. United States*, 43 F.3d 1451, 1452 (Fed. Cir. 1995).

114. *Allum v. Comm'r*, T.C. Memo 2005-177, 2005 Tax Ct. Memo Lexis 178, *35-36. (2005), *aff'd,* 231 F. Appx. 550 (9th Cir. 2007).

115. *See*, e.g., *Clagget v. Comm'r*, 44 T.C. 503 (1965) (where the Tax Court recognized the existence of a partnership that never filed Form 1065 partnership returns, but which had a partnership agreement).

116. 44 T.C. 503 (1965).

117. *Allum v. Comm'r*, T.C. Memo 2005-177, 33; see also *Comm'r v. Culbertson*, 307 U.S. 733, 742 (1949), *clarification of error in citing to Fifth Circuit*, 194 F.2d 581, 592 (1952).

118. *See Luna v. Comm'r*, 42 T.C. 1067, 1078 (1964).

119. *Allum v. Comm'r*, T.C. Memo 2005-177, 33 (citing *Luna v. Comm'r*, 42 T.C. 1067, 1077-1078 (1964)).

120. *Comm'r v. Tower*, 66 S. Ct. 532, 536 (1946) (citing *Drennen v. London Assurance Co.*, 113 U.S. 51, 56 (1885)); see also *Estate of Smith v. Comm'r*, 313 F.2d 724, 729 (8th Cir. 1963); *Luna,* 42 T.C. at 1078.