Forbes

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July 4, 2025

Litigation Funding Tax Was Dropped From Big Tax Bill Before Passage

I recently noted that litigation funders and lawyers were about to face a 40.8% tax courtesy of the One, Big, Beautiful Tax Bill. The unusual excise tax was a controversial part of the then pending tax bill that was roiling the topic of litigation funding. The enormous proposed excise tax on litigation funding proceeds—including tax withholding by lawyers'—was causing some lawyers and litigation funders alike heartburn or even some restless nights.

Big Changes

There were constituents and lobbyists lined up on each side, but as the sausage was being made, the excise tax morphed materially. First, the Senate bill proposed to reduce the withholding rate from 20.4% to 15.9%. That would have meant that, under a typical gross-up provision in a litigation funding contract, a law firm would have been contractually obligated to increase its payments to the funder by 18.9%. That was an improvement over the 25.6% that would have been necessary under the House bill.

But that was not the only change. Significantly, the Senate version also changed the amount to which the withholding rate would apply. The original Tillis bill required withholding on the *full gross amount* of each payment to the funder. The updated Senate bill required withholding only on the amount representing "qualified litigation proceeds," which is defined as the funder's *profit* from the transaction.

However, the bill the Senate passed and that the House also passed does not include it. The Senate parliamentarian ruled that the new litigation funding tax could not be included in the reconciliation process because it was a regulatory provision with only incidental revenue effects. So, the provision is probably dead for now, even if the House wants to revive it.

Will Tax Return?

Even so, some funders have already said they expect the provision in one of its guises to rear its head again in future legislation. The excise tax on funders—with withholding tax enforcement on lawyers—was intended in part to curb litigation. A long list of companies was firmly behind the proposed tax and some have powerful lobbyists. Therefore, some people expect this issue to come back in some form in the future.