Tax-Savvy Assignments of Litigation to Family or Charity

by Robert W. Wood and James L. Kresse

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In this article, Wood and Kresse consider the tax issues and mechanics of assignments in charitable and family tax planning.

Can a plaintiff expecting a litigation recovery assign the expectation of the settlement or verdict to another person or entity? It may sound exotic, but it is more common than you might think. Interests in litigation claims are increasingly assigned in commercial transactions. Commercial transactions, often called litigation finance or litigation funding, are discussed in several articles.[1]

Rather than commercial transactions, this article focuses on gratuitous transfers of interests in litigation made as part of gift or estate planning. Interest in these topics is growing but perhaps not at the pace of interest in litigation funding. One problem with gift, estate, and charitable planning relates to timing because some litigants wait too long.

Despite the assignment of income doctrine, if an assignment is made early enough, it will generally be effective for income tax purposes (and for gift and estate tax purposes too). In a way, there is an assignment in almost every contingent fee case. In a contingent fee case, the plaintiff assigns a portion of any eventual recovery to the lawyer in exchange for services.

That assignment generally occurs at the outset of the case, and almost no one worries about tax implications then. Besides, we may think we understand the income tax effects to the lawyer and the plaintiff in a common contingent fee example. But outside of that context and after the initial time frame, the income tax issues may be less clear.

Varied Playing Field

An assignment may be all or part of the plaintiff's interest in the case. The assignment might be for consideration, or it might be motivated by love and affection. The assignment might be for the convenience of the plaintiff, who transfers 100 percent of the case to a wholly owned entity to move the claim from one pocket to another.

The plaintiff may want to contribute all or part of his interest to a family entity of which the plaintiff owns only a portion. The plaintiff may want any eventual recovery to land in a family limited liability company or partnership owned by multiple family members. Some plaintiffs may even want to assign a portion of the case to charity.

All of those types of assignments are different from commercial litigation funding. Gift and estate planning may seem outside the context of normal income tax worries. Still, taxes — income as well as estate and gift — should be considered, whatever the setting and whatever the timing.

It is surprising that the tax effects of assignments, immediate as well as later when case proceeds come in, might not be considered or might be unclear. The tax issues can be fundamental, raising such questions as who pays tax, on what, and when. It is difficult to generalize about the myriad fact patterns, particularly because the assignment to the attorney may be different from all of the others.

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[1]Robert W. Wood and Jonathan Van Loo, "Investors Who Fund Lawsuits: Form and Tax Treatment," *Tax Notes*, Dec. 16, 2013, p. 1239; Wood and Van Loo, "Litigation Funding: The Attorney's Perspective," *Tax Notes*, Jan. 27, 2014, p. 435; Wood and Van Loo, "Investing in Lawsuits: The Plight of the Plaintiff," *Tax Notes*, May 5, 2014, p. 613; Wood, "Investing in Lawsuits: Excludable Recoveries," *Tax Notes*, June 9, 2014, p. 1203; Wood and Kresse, "Is Litigation Finance Tax Treatment in Jeopardy?" *Tax Notes*, Mar. 7, 2016, p. 1193.

However, because contingent fee attorney arrangements are common, and there is already considerable confusion about the tax treatment of contingent fee agreements, we should start by addressing the attorney's share of the case.

Attorney Fees

The tax treatment of contingent attorney fees is often a hot-button item for plaintiffs. Plaintiffs worry that they will be taxed on their legal fees. Plaintiffs' lawyers are unlikely to let clients handle settlement money, which is generally paid into their trust account. That common practice may add to the ire plaintiffs feel about the tax issues.

For tax purposes, the legal fees are generally seen as paid to the plaintiff and thereafter paid to the contingent fee lawyer. For many years, there was a bitter dispute among the Circuit Courts about whether an assignment of a share of the litigation claim to the plaintiff's attorney would be effective for tax purposes. An effective assignment (in some circuits) meant that a client could exclude from income moneys paid to the lawyer.

But in *Commissioner v. Banks*[2] the Supreme Court held that as a general rule, when a litigation recovery constitutes income to the plaintiff, the litigant's income includes the portion paid to the attorney as a contingent fee. How can the plaintiff be taxed on \$100 if he only ever receives \$60? The Court reasoned that an attorney is the agent of the client.

So, if the attorney receives a \$100 settlement, there is \$100 of gross income to the client. This is so even if the lawyer deducts his \$40 fee and pays the plaintiff the net of \$60. Consequently, the full recovery is income to the client, as principal.[3]

Of course, the client may be able to *deduct* the fees. But tax deductions are separate questions from gross income. And there are different types of deductions of varying effectiveness.

An above-the-line deduction is available for employment cases and federal False Claims Act cases. For most other types of litigation, plaintiffs must often claim their fees as miscellaneous itemized deductions, which are subject to a 2 percent threshold, phaseouts, and alternative minimum tax. When a client says he is paying tax on attorney fees he never saw, it is usually because of miscellaneous itemized deductions and AMT.

Assignment of Income Doctrine

Tax lawyers are accustomed to worrying about the assignment of income doctrine. When income is too close to being actually earned, we know that it cannot be transferred to someone else without tax effect. In some cases, the act of assigning the item actually accelerates the income, making a bad situation worse.

Under the assignment of income doctrine, a taxpayer who earns or has a right to income will be taxed on it.[4] If the taxpayer has the right to receive the income or if based on the circumstances, the receipt of the income is practically certain to occur, it is too late to avoid it. If the right has effectively become a fixed right, even if the taxpayer transfers the right before actually collecting the income, it remains the transferor's income.[5]

In contrast, a transferor of a mere anticipation or expectation of income, rather than a fixed right to it, is not subject to tax.[6] A review of the case law shows that anticipatory assignment of income principles require the transferee to include the proceeds of the claim in gross income when recovery on the transferred claim is *certain* at the time of transfer. Conversely, this is plainly not required when a recovery on the claim is doubtful or contingent at the time of transfer.[7]

How late is too late in a common litigation setting? Is it too late if the plaintiff has already received a jury verdict? Usually not, as long as the case remains disputed, for example, if there has been a timely appeal.

In general, one who transfers a claim in litigation to a third person before the expiration of appeals in the case should not be required to include the proceeds of the judgment in income. The plaintiff

[2]*Commissioner v. Banks*, 543 U.S. 426 (2005).

[3]*Id.* at 436.

[4]*See, e.g., Wilkinson v. Commissioner*, 304 F.2d 469 (Ct. Cl. 1962) (assignment of contract right to ordinary services income to charity treated as ordinary income).

[5]*See, e.g., Ferguson v. Commissioner*, 174 F.3d 997 (9th Cir. 1999); *Jones v. United States*, 531 F.2d 1343, 1346 (6th Cir. 1976); *Kinsey v. Commissioner*, 447 F.2d 1058, 1063 (2d Cir. 1973); *Hudspeth v. United States*, 471 F.2d 275, 280 (8th Cir. 1972); *Estate of Applestein v. Commissioner*, 80 T.C. 331, 345 (1983); *Lucas v. Earl*, 281 U.S. 111, 114-115 (1930).

[6]*Johnson & Son Inc. v. Commissioner*, 63 T.C. 778, 787-788 (1975).

[7]*See, e.g., Doyle v. Commissioner*, 147 F.2d 769 (4th Cir. 1945) (taxpayer who assigned judgment award after it was affirmed on appeal was required to include the proceeds in income); *Cold Metal Process Co. v. Commissioner*, 247 F.2d 864 (6th Cir. 1957), *rev'g* 25 T.C. 1333 (1956) (taxpayer's right to income on a judgment is not earned or does not ripen until all appeals with respect to the judgment have been exhausted); *Wellhouse v. Tomlinson*, 197 F. Supp. 739 (S.D. Fla. 1961) (transferor not taxable on the interest portion of a note when there were legal doubts about the collectability of the note at the time of the assignment); *Jones v. Commissioner*, 306 F.2d 292 (5th Cir. 1962), *rev'g* T.C. Memo. 1960-115 (taxpayer not taxable on award assigned to related corporation when the claim was contingent when assigned); *Schulze v. Commissioner*, T.C. Memo. 1983-263 (taxpayer not required to include in gross income the portion of a litigation claim paid to his former spouse in accordance with divorce property settlement).

should be able to assign his interest in the case while it is on appeal and before any settlement or final judgment. If the plaintiff's assignment occurs while his claims remain contingent and doubtful in nature, none of the proceeds should be included in the assignor's income.

But one must consider the *scope* of the appeal. Suppose that the plaintiff has a verdict for $100 in compensatory damages and $300 in punitive damages. The defendant's appeal of the entire case should mean that the recovery is still inchoate.

However, an appeal of *only the punitive* damages may well mean that the first $100 is in some sense already earned. The claim arguably cannot be assigned without the plaintiff first paying taxes on the $100. One should recognize that the timing in these circumstances is not the same as actual receipt.

That is, the plaintiff may not have *actually* received the $100 in this example. Yet it is at that point too late to assign the $100 of compensatory damages. In contrast, the plaintiff's right to the punitive damages has not yet matured.

Mechanics of Assignment

When assigning an interest in litigation, it is important to consider how the transfer is effectuated. If a taxpayer maintains the benefits and burdens of ownership of an asset while attempting to transfer income from the asset, the assignment of income doctrine could apply to disregard the entire transfer.[8] The retention of benefits may look even more suspicious if there is no (or insufficient) consideration.[9]

Similarly, a nonbinding intent to convey something in the future is not considered an effective transfer.[10] To ensure that an assignment is respected when intended, it is important to properly document it. This is true whether the transfer is for consideration, gratuitous, or a blend of each.

Assignments and Legal Fees

In the case of an assignment involving litigation, most of the focus should be on the claim itself and the income or gain that might eventually arise from it. But there could also be attorney fee issues. And because there can be taxes associated with attorney fees (gross income and deductions), they are also worth considering.

In LTR 200107019, the plaintiffs won a jury verdict for compensatory and punitive damages resulting from their son's death in an auto accident. While the defendants were appealing the verdict, the plaintiffs established a charitable trust. The plaintiffs then assigned the punitive damages portion of the award to the trust.

The IRS concluded that the assignment was effective. Thus, the plaintiffs did not need to include in their income the punitive damages assigned to the trust because receipt of the income was uncertain at the time of assignment. But the IRS reached a different result on the attorney fees.

The IRS reasoned that under the terms of the trust agreement and the contingent fee agreement, the plaintiffs retained the portion of the punitive damages used to pay the attorney fees. Therefore, under *Banks*, the plaintiffs had to include in income the amount of the attorney's contingent fee. This was so even though the plaintiffs were not taxable on the remaining punitive damages.

Could this result have been avoided if the trust agreement had been worded differently? What if the attorney's contingent fee agreement had been amended to include the trust as an obligor? That could well have yielded a different tax result.

If a plaintiff is assigning 100 percent of the claim to an assignee, the parties will probably expect the fee arrangement to also be assigned. The plaintiff's lawyer will almost certainly want that too. And the plaintiff should want a document that terminates his obligations to pay legal fees.

The parties can sign an assignment and novation of the fee contract, coupled with an acknowledgement by the assignee that the fee arrangement remains in place with a new obligor. Arguably, this might occur by operation of law, under state law and federal income tax law. Indeed, the plaintiff no longer has rights in the case, and the assignee stands in his shoes.

So from a tax perspective, the *Banks* problem thereafter presumably belongs to the assignee. The Supreme Court in *Banks* emphasized that a client who retains dominion and control over the underlying claim is properly considered the principal to whom the recovery is attributed.[11] Still, it is appropriate to document it.

Release of Attorney Fee Obligation

Not every assignment of an interest in litigation involves a contingent fee lawyer. But many do. Typically, if there is a contingent fee lawyer, the assignor, assignee, and the lawyer all have an interest in clarifying exactly who owes what to whom.

If the plaintiff is out of the case and out of the fee agreement after the assignment, it is hard to see

[8] *United States v. Shafto*, 246 F.2d 338 (4th Cir. 1957).

[9] *See Greer v. United States*, 408 F.2d 631 (6th Cir. 1969), *aff'g* 269 F. Supp. 801 (E.D. Tenn. 1967).

[10] *Glynn v. Commissioner*, 76 T.C. 116 (1981), *aff'd*, 676 F.2d 682 (1st Cir. 1982); *see Warden v. Commissioner*, T.C. Memo. 1988-165.

[11] LTR 200107019, at 436.

how there could be tax to the plaintiff. However, could a novation of the plaintiff's fee obligations somehow trigger income to the plaintiff? A review of the case law indicates that the release by the attorney of the plaintiff's contingent fee obligation should not trigger income to him.

The plaintiff's agreement to pay attorney fees from a future recovery is not debt, but is entirely contingent. In short, the obligation is still contingent, so releasing it does not trigger cancellation of debt (COD) income. The courts have held that the cancellation of a contingent obligation to pay a third party amounts from future profits does not result in income.

For example, in *Terminal Investment Co. v. Commissioner*,[12] a corporation issued bonds that provided for contingent interest payments. Payments would be made on the bonds only if the corporation had sufficient net earnings. That contingency never occurred. With borrowed funds, the corporation purchased and retired all of these bonds for less than their par value.

The corporation did not report as income any amount attributable to the contingent interest obligation. The Tax Court agreed, reasoning that the corporation was not required to include in income "amounts which it was not then obligated to pay and which it might never be required to pay, even if the scrip certificates [providing for the contingent interest payments] remained outstanding."[13] *United States v. Kirby Lumber Co.*[14] is distinguishable because that case involved a fixed, rather than a contingent, obligation.[15]

Similarly, in *Corporacion de Ventas v. Commissioner*,[16] a foreign corporation was the issuer of bonds under which its liability was limited by law. The obligation to pay interest or principal arose only if the corporation had net earnings sufficient for that purpose. When the corporation later purchased its bonds at a discount from their face value, the IRS argued that the difference was taxable income.

The Second Circuit disagreed, noting that the obligation to make payments was wholly contingent on future earnings. The court reasoned that "[i]f the cancellation of indebtedness results in income on the theory that thereby assets are freed for the debtor's general use, it appears self-evident that the obligation to be retired must be one which *unconditionally* subjects the obligor's assets to liability for the payment of a *fixed* amount."

Should the result be different now that Treasury recognizes that debt instruments may provide for contingent payments?[17] Surely not. The regulations specify that the contingent payment debt instrument regulations and the examples should not give rise to any inference regarding whether the instrument is a debt instrument for tax purposes.[18]

LTR 201027035 supports this view. In that ruling, the taxpayer discharged an obligation under a tax indemnity agreement by paying the obligee a lump sum payment. Even though the taxpayer deemed the obligation to be indebtedness within the meaning of section 61(a)(12), which the IRS seemed to have accepted, the ruling stated that the discharge of the obligation did not give rise to COD income.

As in *Corporacion de Ventas*, the IRS said that the obligation under the tax indemnity agreement was contingent on the taxpayer's future earnings. Therefore the discharge of the obligation did not result in COD income. With traditional contingent fees, the plaintiff's obligation to pay depends entirely upon whether he obtains a recovery. If a recovery remained speculative at the time of the assignment, the plaintiff cannot be said to owe *any* fees to his attorneys.

If a fee agreement calls only for contingent fees payable upon a recovery, it is uncertain whether the plaintiff will ever owe those fees. The assignment was effected during a time of uncertainty so there could be no income to the plaintiff. Accordingly, a discharge of the plaintiff's contingent fee obligation before it became fixed and payable should not result in income to him.

The plaintiff's contingent obligation to pay fees also bears an analogy to the liabilities that are excluded from treatment as consideration in a tax-free exchange under section 357(c)(3). In general, under section 357(a), a taxpayer must reduce its basis in property received in a section 351 tax-free exchange to the extent of any liabilities that are assumed. But there is an exception for liabilities that would give rise to a deduction.

After a liability is assumed by the controlled corporation in a section 351 transaction, the payment of the liabilities would no longer generate a deduction for the transferor. Section 357(c)(3) was intended to prevent taxation of phantom gain because the liability would have given rise to a deduction had the liability not been assumed. Similarly, to treat the discharge of the plaintiff's contingent fee obligation as income would have resulted

[12]*Terminal Investment Co. v. Commissioner*, 2 T.C. 1004 (1943), *acq. Corporacion de Ventas v. Commissioner*, 130 F.2d 141 (2d Cir. 1942).
[13]*Id.* at 1013.
[14]*United States v. Kirby Lumber Co.*, 284 U.S. 1 (1931).
[15]*Id.* at 1013-1014.
[16]*Corporacion de Ventas*, 130 F.2d 141 (2d Cir. 1942).
[17]Reg. section 1.1275-4.
[18]*See, e.g.*, reg. section 1.1275-4(b)(4)(vi).

in phantom gain to the plaintiff, because the plaintiff would have been entitled to deduct the fees had the charity not assumed the fee obligation.

Charitable Contributions

Family and estate planning as a large litigation matter progresses is more common than charitable contribution planning in this context. However, the charitable setting should not be overlooked. A plaintiff may want to assign a share of the case to charity to achieve a better tax result than the charitable contribution rules might afford.

There is also the public relations element. Many a celebrity has said that a litigation recovery is all about the principle and that they are donating the money to charity.[19] A charitably minded plaintiff may not want to wait to win or settle the case and then donate the money thereafter.

Can the plaintiff shortcut this series of events and assign the plaintiff's interest in the case to charity? Surely the answer should be yes, if timely and properly done. Is there any income to the plaintiff on that assignment? No, there should not be.

Is there any income to the plaintiff when the case is later resolved? Again, hopefully not. Does the presence of a contingent attorney fee agreement in the case complicate or prejudice the result? This answer should also be no, but this point may be the most delicate part.

It is important that when the assignment is made to the charity, the result in the litigation is not certain. It is also important for the assignment to be complete. Done properly, neither the assignment by the plaintiff nor the subsequent disposition of the case by the charity should have an adverse income tax impact on the plaintiff.

If the plaintiff must report and pay tax on the recovery, he would only give the net difference to the charity. In general, contributions are limited to 50 percent of the taxpayer's adjusted gross income for the year. For that reason, the charity would lose out on part of any ultimate litigation proceeds if the plaintiff is required to receive the money first, donating only the deductible amount.

Instead, the plaintiff and the charity might agree that the plaintiff will assign the case to the charity. The charity would then also step into the shoes of the plaintiff with the contingent fee lawyer. One potential bone of contention concerns previously expended costs.

Suppose that the contingent fee lawyer was unwilling to advance all costs? That means the plaintiff has probably paid some or all of the costs. Now, the plaintiff will assign his claim to charity, assigning also the fee contract with the lawyer.

But can the plaintiff be reimbursed for the costs the plaintiff has advanced before the assignment? Some plaintiffs may forgo that point. Some may not. From a tax viewpoint, it is cleaner if the plaintiff is not reimbursed for previously paid costs.

In any event, the plaintiff may be able to take a deduction for previously paid costs as a donation to charity, assuming that the costs are reflected in his basis.[20] Still, even if there is reimbursement, it should not spoil the tax treatment of the assignment. In either event, of course, the matter should be discussed, and it should be addressed in the documents.

The assignment agreements will generally need to refer to applicable law, generally to state law. Many states, including New York and California, have recognized such assignments as transfers of the property rights of legal claims.[21] There may be several documents executed at or about the same time. There may be an assignment agreement; a release and novation agreement for the plaintiff, assignee, and the contingent fee lawyer; and a new fee agreement for the assignee and the lawyer.

In one notable case, a plaintiff who did not want any eventual recovery wanted to donate the case to charity. However, the plaintiff was extremely risk averse and wanted an IRS ruling.[22] Because the ruling was required by the plaintiff as a condition for making the assignment, the assignment was made conditioned upon the receipt of the favorable IRS ruling.

The IRS agreed that there was no income to the plaintiff, even though the case had proceeded to verdict and was on appeal at the time of the

[19]For example, Michael Jordan recently announced the donation of settlement proceeds related to the unauthorized use of his likeness to Chicago-area charities. *See* Kim Janssen, ''Michael Jordan Hands Court Settlement to 23 Chicago Nonprofits,'' *Chicago Tribune*, Dec. 15, 2015, *available at* http://www.chicagotribune.com/business/ct-michael-jordan-charity-1216-biz-20151215-story.html.

[20]Section 170(e)(1).

[21]*See, e.g., Essex Insurance Co. v. Five Star Dye House Inc.*, 137 P.3d 192 (Cal. 2006) (approving an assignment of claims for economic losses, noting that California policy favors transferability of all causes of action except for purely personal claims such as for slander or emotional distress); N.Y. Gen. Oblig. Law section 13-101; *DiLallo v. Fidelity & Casualty Company*, 355 F. Supp. 519, 522-523 (S.D.N.Y. 1973) (citing New York cases permitting assignment of claims for conversion, fraud, and deceit); *In re Public Administrator of Kings County*, 206 Misc. 768 (N.Y. Sur. Ct. 1954) (holding that there is no statutory prohibition, nor is it against public policy, for a widow to assign all of her claim, right, title, and interest in her husband's estate); D.C. Code sections 28-2301 and 28-2304.

[22]LTR 201232024.

assignment. The contingent fee attorney would be paid on the eventual recovery if it came (which it later did), so the attorney fee also was not income to the plaintiff. It was a good result for the plaintiff's wishes, the plaintiff's taxes, and for the charity.

Transfer by Gift

Rather than assigning a portion (or all) of the litigation claim to charity, what if the plaintiff assigns it to family members as gifts? For example, the plaintiff could gift a 10 percent share to each of three children, retaining 70 percent for himself. Alternatively, the plaintiff could transfer 50 percent of his interest in the case to a family LLC or limited partnership.

The plaintiff could then make gifts of the LLC or partnership units. There is considerable variation in the mechanics as well as the end result. But the tax goals are generally consistent. A plaintiff trying to take such steps is usually thinking both about income tax planning and transfer tax planning.

If a large recovery is expected, the plaintiff hopes to achieve income-splitting with family members by having them as direct recipients of a share of the proceeds from the defendant. That may be taxed at a lower rate than if the plaintiff receives it all. Apart from income taxes, the plaintiff may want to be sure that once the income tax is paid, the funds are already in his children's hands.

Presumably, if the gift is documented before the recovery becomes certain, the value of the litigation at the time of the transfer (the amount of the gift) will be less than the amount ultimately recovered. In this way a gratuitous transfer can be income tax and transfer tax efficient. Conversely, suppose that the plaintiff parent receives and pays income tax on all of the recovery, gifting after-tax moneys to a child. The child might be in a lower income tax bracket.

Moreover, the parent is using up his or her lifetime transfer tax credit. An assignment or gift during the pendency of the litigation is simply more tax efficient. The tax advantages can multiply with a family LLC or limited partnership. It may be possible to enhance at least the transfer tax goals with discounting based on minority discount and lack of marketability.

For example, assume that an individual wants to give $50 to family members. Clearly, he could give this gift free of *income* tax, but the $50 transfer would count against his lifetime gift and estate tax exemption. Another option is to form a limited partnership, contribute the $50 to the partnership, and gift limited partnership interests to the intended recipients.

The partnership documents can be drafted so there are restrictions on the transferability of the limited partnership interests. The units may be nonvoting and unmarketable. In this way, even though the limited partnership holds $50 of cash, the value of the partnership interests (the value of the gift) may be something less than $50, maybe $40, perhaps even $30.

Instead of cash, perhaps the taxpayer has an interest in litigation that he wishes to gift. If the asset is contributed to an appropriately constructed limited partnership, there will be restrictions. Surely the fair market value of the gift (interests in the limited partnership) will be worth less than the FMV of the litigation interest at the time of the transfer.

Is there a business purpose for the partnership beyond the tax benefits from reducing the value of the gift? Often there is. Although litigation may not be a common family business, such techniques can be used to involve family members in the process.

Moreover, quite apart from the genesis of the money, when there is a recovery, there are investment goals. Family partnerships are often used as a way to pool and invest assets. They are also a common and accepted part of a long-term estate plan. As with any tax planning, one must consider the downside.

For example, if the plaintiff has already used his lifetime gift and estate tax exemption (or does so as a result of the gift of the lawsuit interest), gift taxes may be due in the year of the transfer. In the case of a gift, the basis of the property in the hand of the donee is generally the same as the donor's basis.[23] The basis is generally increased by any gift tax paid.[24]

However, gift tax rates often exceed income tax rates that would otherwise be applicable to the litigation recovery in the hands of the assignee. By considering all the potential taxes resulting from an assignment, it is possible for a plaintiff to maximize the tax savings. For example, perhaps the value of the gifted litigation interest is less than the annual exclusion amount (approximately $28,000 for a married couple per donee).

If so, the plaintiff can effectively avoid the gift tax issue and not even use any lifetime exemption. The earlier the assignment takes place, the better the argument is for a reduced value at the time of the gratuitous assignment. More generally, of course, earlier consideration of these issues often yields better and more thoughtful results.

Conclusion

Litigation recoveries might represent the largest lump sum payment of a taxpayer's life. Thus, it is

[23]Section 1015(a).
[24]Section 1015(d).

well worth considering long-term goals, including estate planning, charitable goals, and the benefits of periodic payments as part of a structured settlement. It is best to do it before the money is paid, before the settlement documents are signed, and hopefully before settlement discussions coalesce. Hopefully long before!

Assignments of litigation can also be an effective tool for tax-efficient charitable giving. Properly timed, an assignment of litigation to a charity can effectively eliminate the taxes due on the recovery and can obviate the normal percentage limitations on charitable giving. In the estate-planning context, gifts of litigation can achieve income-splitting goals, potentially reducing the income tax rate applicable to the recovery and redistributing it.

Assignments can also significantly reduce the value of the gift for estate and gift tax purposes. Of course, it might be impossible to believe that a claim valued at $50,000 becomes worth $5 million 60 days later. Perhaps there is no justification for that kind of swing.

And yet, there might be an explanation if a case that was moribund and facing dismissal was suddenly and unexpectedly resurrected. The facts and the details matter, as does the documentation. It is often said that in life, timing is everything. The same can be said about assignments of litigation.

In a worst-case scenario, one can be worse off than having done nothing. A poorly timed assignment can result in income tax without the cash to pay it. The attorney's contingent fee must also be considered to ensure that the plaintiff is not left with income related to the contingent fee and a largely unusable deduction.

To avoid this fate the assignment should be made before the proceeds to the litigation become fixed. The assignment should be effectuated with carefully crafted documents that verify the parties' intent. That way, plaintiffs can harness the full power of their litigation recoveries to achieve their long-term plans. ■