Wood Defends Discussion of QSS Rules

To the Editor:

I am responding to the comments by Profs. Polsky and Hellwig (''Professors Critique Wood's Discussion of QSS Rules,'' *Tax Notes*, May 17, 2010, p. 829, *Doc 2010-10584*, *2010 TNT 94-11*), who wrote a thoughtful disagreement with my article, ''Unqualifying Qualified Structured Settlements,'' *Tax Notes*, May 3, 2010, p. 581, *Doc 2010-7959*, *2010 TNT 87-5*. Our most important disagreement involves attorney fee structures. Even there, it may be mostly an academic argument.

Yet as real life practice on these issues is still developing, I think it's worth trying to clarify. More important, there is one point in Profs. Polsky and Hellwig's letter of potentially momentous impact. I acknowledge (again) that there are two views: (1) that attorney fee structures piggy-back on a plaintiff's section 104 damages, so attorney fee structures qualify for a section 130 assignment; or (2) that they are a type of deferred compensation that doesn't qualify.

I don't think I said the first theory is wrong. I did say the second theory makes more sense to me. It still does, all the more so after reading Profs. Polsky and Hellwig's letter. I like attorney fee structures. I think plaintiffs' lawyers are lucky to be able to take advantage of them. More of them should.

What doesn't make sense to me is the notion that all the payments must be treated as made to the client first, followed by the attributed payments from client to lawyer. If you follow the Polsky/Hellwigian path, the money actually goes from (1) defendant to plaintiff; (2) plaintiff to assignment company; (3) assignment company to issuing life insurance company; (4) issuing life insurance company to assignment company; and (5) assignment company to lawyer. True, this is a terribly formalistic area of the law, and maybe it needs to remain thus. Also true, *Banks* suggests it. But I still don't think it's as clear as Polsky and Hellwig suggest that *Banks* resolved it all, nor even if it did, that this tortured path is a good one.

Clearly, as my May 3 column notes, *Banks* helps the argument. Even back in 2005 when *Banks* was a two-week old newborn, I remarked that it appeared to support the theory of attorney fee structures, and I thought would lead to more of them. See ''Supreme Court Attorney Fees Decision Leaves Much Unresolved,'' *Tax Notes*, Feb. 14, 2005, p. 792, *Doc 2005-2351*, or *2005 TNT 24-67*.[1] I still think so, but it is overstatement to say *Banks* resolves the issue.

Besides, if I read Profs. Polsky/Hellwig correctly, the *Banks*-like multiple assignment (which they say makes

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[1] I noted that:

A related point is that structures of attorney fees should get a boost from the implications *Banks* has on section 72(u). That section taxes the cash buildup in value of a life insurance policy in some cases. A notable exception is a ''qualified funding asset'' as defined in section 130(d). That provision therefore favors qualified structured settlements (under sections 104 and 130) as opposed to unqualified (meaning taxable) ones. It has led some insurance companies to position assignment companies outside the United States for nonqualified structures. The *Banks* decision suggests that contingent attorney fees generally belong to the client first, so that even the attorneys' portion of the award can be structured with a domestic assignment company. The fact that structures of attorney fees can be domestic in light of *Banks* suggests that there may be more attorney fee structures.

section 130 applicable) triggers section 5891! If they are right, this is far more significant — and far more debilitating — than anything else we are discussing. They say section 5891's application should hopefully not trigger an excise tax, because the lawyer can go to court for an order saying the transfer is OK. That's hardly comforting to practitioners. The lawyer trying to structure his fees now must go to court to get a ''qualified order'' (meeting the requirements of section 5891(b)(2)) about the fairness of the assignment of periodic payments to the client (these fictitious periodic payments that will look like they are to the lawyer).

Section 5891 hearings are usually done in an independent court proceeding. Here, maybe Profs. Polsky/Hellwig have in mind going to the judge who has waning jurisdiction over the case that is resolving, or perhaps to another judge. Either way, no contingent fee lawyers I know would do this, and even if they did, it could add weeks or even months of delay. The factoring companies may now be comfortable with section 5891 and the hurdles to getting a qualified order, but the thought that the plaintiff's lawyers might need to have their fee agreement vetted in court will send them screaming into the night (maybe I exaggerate, but not by much).

In fairness, maybe Profs. Polsky/Hellwig are not really serious about section 5891 (whether or not they are serious, I hope they are wrong about its applicability). In any event, I want to be *extremely clear* that I'm not saying the piggy-back theory is wrong or that the fee structures done via a qualified assignment are ineffective. Most life insurance companies do it. What I said (or *tried* to say) and believe is that the insurance company business decision to structure attorney fees via a nonqualified assignment makes more sense to me.

Whether a structure works ought to be dependent on constructive receipt and economic benefit principles as those doctrines were applied in *Childs v. Commissioner*.[2] The notion that tax law suggests that a fee structure should work only if the client structures too, or only if the lawyer and client structure *pari passu*, doesn't make sense to me (sorry, there's my imprecise phrase again).

From a purely practical perspective, I find it strange that different (all very conservative) life insurance companies write structured fees differently. I agree with Profs. Polsky/Hellwig that some companies believe in the piggy-back construct. But for some of them, I think it is because they are limited by only having a qualified assignment company as a subsidiary. If they want to ''sell'' attorney fee structures, they must do so on a qualified (piggy-back) basis. I predict some of them might react differently if they had both qualified and nonqualified assignment companies.

On an even more practical level, I don't think any plaintiff will account for a structure as Profs. Polsky/Hellwig suggest, as a flow-through for all of the years of the structure. If their lawyer is due to receive structured fees over 20 years, no client will treat the fees as coming to them in installments over that period, matched by payments out to the lawyer. If you consider the model of a taxable case, it is easier to see that this may sound good in theory but is unlikely in practice. I tried to say some of what Profs. Polsky/Hellwig assert in ''Attorney Fee Structures, *Banks,* Forms 1099, and Catch-22,'' *Tax Notes*, Jan. 21, 2008, p. 401, *Doc 2008-366*, or *2008 TNT 15-76*. My focus there was on messy reporting issues I was seeing in taxable cases.[3]

Profs. Polsky and Hellwig make a number of other interesting points. Perhaps the nitty-gritty of practice makes much of our theoretical debate unimportant. Yet I don't believe the structured settlement portion of the life insurance industry has fully considered the efficacy of the ''savings clause'' I was trying to expose. Profs. Polsky/Hellwig believe the savings clause is more effective than I suggested, for example, in noting the treatment under section 72(u). Perhaps they are right, but I still see a real life dilemma if a qualified assignment turns unqualified.

Very truly yours,

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[2]103 T.C. 634, *Doc 94-10228*, *94 TNT 223-15*, *aff'd without opinion*, 89 F.3d 856 (11th Cir. 1996), *Doc 96-19540*, *96 TNT 133-7*; *see also* Robert W. Wood, ''Structuring Attorney Fees: Kingdom of Heaven?'' *Tax Notes*, Aug. 1, 2005, p. 539, *Doc 2005-15920*, or *2005 TNT 142-28*.

[3]I noted:
If this client is stuck with only a small portion of the deduction in the year of the settlement (because his attorney chose to structure his fees), the client may need to worry over the next 10 years of tax returns about an above-the-line deduction. This may raise audit risk, be an annoyance, and so on. Of course, some clients may structure, and perhaps that helps ameliorate this. But the client may structure over a shorter or longer period than the lawyer. The client may structure over 5 years or 15 years, yet the attorney fees (and the Forms 1099 respecting them that are sent to the client) will presumably be governed by the attorney's distribution scheme (10 years, in my example). This may lead to many mismatches.
Id.