

TREASURY PRESERVES STRUCTURED ATTORNEYS FEES

Recent federal tax legislation threatened the future use of structured attorneys fees. Those are arrangements in which attorneys elect to defer their receipt of contingent fees earned in settling cases. The structured fees are taxable only when received. That arrangement achieves several valuable objectives for attorneys. It defers income until retirement. It levels cash flow over future years to make a contingent-fee practice more predictable, or to fund costs for future cases. And it saves money by deferring tax until future years.

Late in 2004, Congress passed a sweeping revision of the rules for deferred compensation . . . the American Jobs Creation Act of 2004, Pub. Law No. 108-357, 118 Stat. 1418. The revised rules would have put a stop to structured attorneys fees until further guidance was published by the Treasury Department. That guidance could have made the rules difficult to satisfy for attorneys, ending the ability to structure attorneys fees.

However, in response to requests from several groups concerned about taxpayers who earn fees and commissions from several, rather than single, sources, the Treasury Department removed contingent-fee attorneys from the group of taxpayers affected by the American Jobs Creation Act of 2004. The Treasury guidance, published December 20, 2004, removes attorneys from the new rules with the following interim guidance:

“[The new law] does not apply to arrangements between a service provider [the attorney] and a service recipient [the client] if (a) the service provider is actively engaged in the trade of business of providing substantial services, other than (i) as an employee or (ii) as a director of a corporation; and (b) the service provider provides such services to two or more service recipients to which the service provider is not related and that are not related to one another.” Treasury Notice 2005-1, A-8, (Guidance Under § 409A of the Internal Revenue Code, Dec. 20, 2004).

Thus, the old rules continue to apply.

What are the old rules? First, the attorney must elect to defer his or her fees prior to the date on which those fees are earned. In a contingent-fee case, fees are normally earned at the time that the client receives money in settlement.

Second, that election must be reflected in a writing. The writing can be an amendment to the original contingent-fee agreement, if that agreement does not already deal with structured attorneys fees. The writing can also be the settlement agreement or release between the client and the defendant or its insurer.

2 Third, the writing should contain the timing and amount of each future payment to be received by the attorney. Thus, the attorney should make early contact with a structured-settlement professional to determine the stream of payments available and the insurance company providing that stream.

For those interested in reading about the technical tax arguments in structuring attorneys fees, see *Childs v. Commissioner*, 103 T.C. 634 (1994), *aff'd per curiam*, 89 F.3d 856 (11th Cir. 1996). In that case, the Tax Court, which is a court of national jurisdiction in tax cases, agreed with the attorney-taxpayers, and the 11th Circuit affirmed without an opinion. Since that time, no other cases have been published dealing with structured attorneys fees, nor are we aware of any audits on the issue since that decision. The recent guidance by the Treasury under the American Jobs Creation Act seems to be more support for the deferral of contingent fees.

As is true for clients, structured attorneys fees are funded with an annuity purchased from one of the dozen-or-so life insurance companies that sell structured-settlement annuities. As a trade-off for all of the tax and financial benefits of the deferred-compensation arrangement for attorneys, the payments from those annuities cannot be accelerated, deferred or pledged as security for loans. So planning in the beginning for the timing and amount of each payment is important . . . another reason for early contact with your structured-settlement consultant.

Note that the above discussion and the *Childs* case apply to contingent fees earned in physical injury cases in which your client is not taxed. If you are settling a discrimination or employment or other taxable cases, other rules apply and your structured settlement professional can explain those rules to you.

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