STRUCTURING YOUR FEES

CONCEPT:

If an attorney has a contingent fee arrangement with a client, they may enter into a structured legal fee arrangement prior to resolving the case (by either a judgment or a signed settlement agreement). In a structured fee arrangement, the defendant, instead of paying the attorney's fees for the case in a lump sum at the time of settlement, can fund an arrangement that pays the fees over time.

Structuring attorney fees can be a vital tool in deferring income, on a guaranteed basis, into future years to smooth out tax consequences in years with a high marginal tax bracket. Along with reducing the peaks and valleys of a legal practice, providing for retirement, or contributing to estate planning.

BASIS:

Childs v. Commissioner

In *Childs v. Commissioner* (103 T.C. 634 (1994), aff'd without opinion 89 F.3rd 56 (11th Cir 1996)) the IRS unsuccessfully challenged the tax deferral of three attorneys receiving their fees on a periodic payment basis. The IRS argued that since the attorneys were entitled to all the fees at settlement, the doctrine of constructive receipt was applicable and taxes were due on the whole stream of fees in the year of the settlement. The tax court rejected the IRS's argument, as did the 11th Circuit Court of Appeals, holding that the attorneys' deferred fees were not includable in gross income in the year of the settlement and HELD:

1. The fair market values of Petitioners' rights to receive payments under the settlement agreements were not includable in income under sec. 83, I.R.C. in the year in which the settlement agreements were effected, since the promises to pay under the structured settlements were neither funded nor secured and thus did not meet the definition of property for purposes of sec.83.

2. FURTHER, the doctrine of constructive receipt is inapplicable, since Petitioners' had no right to receive the attorney's fees prior to the time the agreement fixing a structured
settlement was entered into.

Private Letter Ruling (PLR) 200836019

Although *Childs v. Commissioner* (103 T.C. 634 (1994), aff'd without opinion 89 F.3rd 56 (11th Cir 1996)) set structuring attorney fees into full swing, giving a precedent on the tax treatment of deferred fees in the form of periodic payments, there still continues to be no ruling from the IRS on such a practice. However, the PLR (Private Letter Ruling) 200836019 released September 5, 2008, should stand as affirmation of Treasury's current stance on the *Childs* decision.

It is not what the holding of PLR 200836019 sets forth that is pertinent to fee structuring, but that the IRS not only cited the *Childs* case several times but has done so in a favorable manner. Although indirectly, the holding of PLR 200836019 appears to set the tone for how the IRS will continue to view the deferral of attorney's fees with the utilization of a Structured Settlement.

IRS Code- Section 409A

Section 409A initially brought concern to the tax treatment of structured legal fee arrangements. However, on December 20, 2004, guidance was issued in Notice 2005-1, clarifying that this section does not apply to arrangements between a service provider and a service recipient if (a) the service provider is actively engaged in the trade or 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.

PROCESS:

Proposal:

Prior to resolving the case (by either a judgment or a signed settlement agreement) individualized proposals are prepared at the request of the attorney.

- All or part of the fees due can be structured
- Payout streams can be illustrated on any date and in most any fashion
- Plaintiff does not need to structure any of their settlement
- A proposal <u>must</u> be selected by the attorney before any settlement documents are prepared and before any settlement funds are dispersed.

Settlement Procedure & Documents:

- Defense <u>must</u> issue a separate settlement check to fund the attorney fee structure, made payable to company selected in the proposal process.
- Annuity payments and language for attorney fees <u>must</u> be incorporated in the Settlement Agreement & Release executed by the plaintiff and attorney.
- Attorney & Plaintiff <u>must</u> sign an UQA&R (Uniform Qualified Assignment & Release) containing attorney fee convenience language.
- Attorney <u>must</u> compete a W-9 or W-4P (depending on life company)
- Attorney <u>must</u> execute a Hold Harmless Agreement
- **1099's will be issued by the life company on the payments paid in that year.