

MEMORANDUM

TO: Pinnacle Bank and Interested Third Parties

FROM: Wood LLP

DATE: March 17, 2023

RE: Legal Fee Lending Solutions -- Frequently Asked Questions

Wood LLP is serving as tax counsel to Pinnacle Bank regarding *Legal Fee Lending Solutions*, Pinnacle's attorney loan program ("Program"). This informal memo considers frequently asked questions about the Program and its tax aspects. We prepared this memo at Pinnacle's request to summarize complex tax topics. It is solely for informational purposes, does not constitute legal or tax advice, and does not waive Pinnacle's attorney-client or work-product privileges with our law firm. Attorneys interested in the Program should consult their own legal and tax advisors and consider their individual circumstances.

FAQ # 1: How Do I Start?

A: If you are interested in Pinnacle's Program, please contact Steve Scott at (615) 743-8725 or steve.scott@pnfp.com.

FAQ # 2: Do I first collect my contingent fees?

A: No, in fact, it is too late to structure your fees if you have received them. It is too late even if you only receive them in your trust account. Before your client signs a settlement agreement, it should specify that the defendant or qualified settlement fund will pay your fee by making a series of future periodic payments to you. Mark Wahlstrom at Wahlstrom and Associates (480) 478-0183 can help you insure that the wording in your client's settlement agreement is correct.

FAQ # 3: What happens then?

A: The defendant in the lawsuit (or its insurance company) or a QSF does not want to pay you your deferred fees over many years, and you don't want that either. Instead, the settlement agreement will call for the defendant or QSF to assign its obligation to make the periodic payments to Dominion Assignment Company (Switzerland) SPC Limited, an unrelated assignment company organized in the Cayman Islands and managed in Switzerland ("Dominion"). To compensate Dominion for assuming this

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obligation, the defendant or QSF will pay Dominion a lump sum approximately equal to the amount of fees you are deferring. Once this payment is made, you release the defendant or QSF from any further liability for your fee.

FAQ # 4: Does Dominion then just hold the settlement funds and pay me according to the schedule I request?

A: Not exactly. Dominion takes the funds and buys an iStructure Annuity from Independent Life Insurance Company, an unrelated insurance company, which it will hold to fund its future periodic payments to you. This annuity combines a regular fixed dollar payment *and a variable amount* that reflects the performance of a stock-market index (the "Indexed Payment"). The Indexed Payment may be zero or may be significant, depending on market performance.

FAQ # 5: Can't I own the annuity myself and receive the annuity payments that way?

A: No, if you are the owner of the annuity, the IRS will say that you are taxable on the entire legal fee you tried to defer.

FAQ # 6: Since Dominion will owe me the periodic payments, can I get a security interest in the Annuity?

A: No, you cannot have any direct interest in the Annuity. For tax reasons, you can have only the rights of a general unsecured creditor of Dominion. If Dominion granted you a security interest in the Annuity, the IRS would again say you are taxable on the entire deferred fee.

FAQ # 7: Can I pick any fixed period of time to receive payment, such as payments over 5 years or 20 years?

A: Yes, the only condition is that you must make your choice at the time you set up the legal fee deferral.

FAQ # 8: What happens if I die before I receive the entire stream of payments?

A: Your death will not accelerate payment of the remaining payments. If you have borrowed from Pinnacle, any periodic payments that are being applied to your loan will continue to be paid to Pinnacle after your death. If you wish, your agreement can provide that the remainder of any periodic payments will be paid to your chosen beneficiaries. Otherwise, the remaining periodic payments will be paid to your estate.

FAQ # 9: If I borrow from Pinnacle Bank, how does that work?

A: If you complete an application and are approved, Pinnacle will make a recourse loan to you of up to 70% of the amount of legal fees you deferred. You agree to repay the loan with interest in a series of equal monthly installments over the term of the loan.

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FAQ # 10: How do I make monthly loan payments?

A: The terms of the loan are designed so that the monthly payment under the Annuity is sufficient to cover your monthly loan payment to Pinnacle. You will be required to give Dominion irrevocable instructions to pay the amount of your monthly loan payment to Pinnacle to service your loan. Dominion will then arrange for Independent Life to send a corresponding portion of the monthly Annuity payment directly to Pinnacle. Consequently, you will not have to bother with monthly payments to Pinnacle to pay down your loan.

FAQ #11: Can I arrange instead to pay the loan back in a lump sum in 10 or 20 years?

A: That is not permitted under the Program. Pinnacle's willingness to lend at a very favorable rate of interest depends on there being only a minimal risk of a loan default. The Program is designed so that Pinnacle is repaid over the course of the loan from the stream of payments generated by the Annuity. This allows Pinnacle to rely on Independent Life's strong credit rating when it sets the interest rate on your loan.

FAQ #12: Do I have to pay tax on the amounts that are paid to Pinnacle each month?

A: Yes, all amounts that Dominion or Independent Life pays to you *or to a third party for your benefit* (e.g., the loan payments to Pinnacle) are taxable to you in that year as deferred payments of your attorney fees. So, it is important for you to have enough liquidity to meet your resulting tax obligations. You and your tax advisor should take this into account when deciding how much to borrow. Steve Scott can discuss your options with you.

FAQ # 13: When I borrow money from Pinnacle, the borrowed money is not taxable to me, correct?

A: Correct. It is a fundamental tax principle that the proceeds of a *bona fide* loan are not income to the borrower. Of course, if a loan is discharged or forgiven (so you don't have to pay it back), it becomes taxable income at that time.

FAQ # 14: Does deferring legal fees with Dominion and Independent Life, and then borrowing up to 70% from Pinnacle make the fees or loan proceeds taxable to me?

A: There is some tax risk to the Program, particularly now that the IRS has recently indicated more interest in structured legal fees (see **FAQ # 15** below). However, after evaluating the tax authorities and how Pinnacle will administer its Program, we have issued a formal tax opinion to Pinnacle that there is substantial authority to conclude that a properly structured legal fee deferral and a properly structured loan should be respected for tax purposes. (See Legal Disclaimer below.)

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FAQ # 15: What about the IRS's recent memorandum attacking attorney fee deferral structures?

A: In December 2022, the IRS issued a Generic Legal Advice Memorandum ("GLAM") that takes issue with certain structured legal fees. The GLAM is a lengthy 25-page internal IRS memo that raises issues many thought were settled. It does not have the force of law and is not binding on any taxpayer. However, it does suggest that dotting i's and crossing t's with these transactions is very important. If you want to read more of our assessment of the GLAM, please see [here](#).

FAQ #16: What if I have more tax questions, can I contact Wood LLP?

A: Yes, but we first ask that you please contact Pinnacle (Steve Scott, at (615) 743-8725) so we can be sure that Pinnacle is comfortable with us speaking with you. If you want tax advice about your personal circumstances, including a tax opinion about your personal structure, we are willing to help if Pinnacle approves it.

Caution: This memo is only a short and simplified summary of complex issues. Wood LLP is not your lawyer, and this is not legal or tax advice. Neither our tax advice to Pinnacle nor the views expressed in this informal memo provide any guarantee that the Internal Revenue Service, any state tax authority, or any court would agree with the analysis above. Attorneys interested in the Program should consult their own independent tax and legal advisors.

We hope this FAQ memo is helpful to you. Please contact Pinnacle for more information about the Program.

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