

Structured Attorney Fees Can Reap Long-Term Benefits

By Patrick Farber

Most attorneys are familiar with creating structured settlements for their fees whenever their personal injury clients agree to their own structured settlement. Many attorneys, however, are unaware that these same fee structures can be arranged on a stand-alone basis--even when the client chooses to accept a lump sum payment or in certain non-injury, contingency fee cases.

Much like their personal injury clients, attorneys receive their fees over time instead of in a lump sum payment with a structured fee settlement. While the fee payments do not enjoy the same tax-free status as client payouts, taxes on the payments are due in the year the income is actually received (via IRS 1099 form). These arrangements can be beneficial to attorneys who wish to:

- delay income to later years when their marginal tax bracket may be lower
- guarantee a predictable and stable income stream over a period of years-- not prone to market fluctuations or the health of the legal practice
- set aside money or arrange lump sum payouts specifically for retirement or children's educational costs
- possibly reduce tax obligation by spreading out income over time

As with structured settlements for clients, the terms and processes of the structured settlement must be hammered out at the time a case is settled.

The Internal Revenue Service has attempted to tax the fees in their entirety in the year the settlement arrangements were made. If allowed, the IRS effort would have negated a major benefit of structured settlement fees. In *Richard A. Childs, Et al. v Commissioner of Internal Revenue* 103 T.C. No. 36 Docket No. 15639-92 (1)(2) 103 T.C. 634 (1994), affirmed 898 F3d 856 (June 11, 1996), the IRS audited the tax returns of two attorneys in the years the attorneys had set up structured settlement payments.

The IRS argued that since the attorneys' future payments were secured and funded, taxes should be imposed in the year the settlement was arranged. The Tax Court disagreed, "...The mere fact that several insurance companies guaranteed the payments to petitioners is irrelevant to our determination of whether petitioners' right to receive the future payments were secured."

Not to be deterred, the IRS also argued that the attorneys were in constructive receipt of the fees during the year of the settlement and should be liable for taxes on the entire amount. Again, the Tax Court said no, "...petitioners did not constructively receive their attorneys' fees for each case in the year that case was settled. In the year each structured fee agreement was entered into, there was no money or property available at petitioners' unfettered demand from the structured fee agreement."

The American Jobs Creation Act of 2004 (Section 409A) attempted to override *Childs*, making fees taxable in the year they were arranged. This time, the Department of the Treasury and IRS issued guidance that excludes most service providers including lawyers from the requirement. The guidance did caution, however, that other tax principles might apply.

Attorney fee structured settlements can also be arranged for many other non-physical injury, contingency fee cases under Int. Rev. Code § 104(a)(2). They include discrimination, sexual harassment, employment, defamation, wrongful termination, bad faith, breach of contract and construction defects cases. For these types of cases, annuity-like periodic payment assumption reinsurance agreements and non-qualified assigned annuities are used.

For the structured settlement to be viable:

- the attorney's contingency fee attorney-client agreement must allow fee structuring
- the attorney or law firm must not receive fees prior to creation of the structured settlement
- the attorneys' fee structured settlement must be created prior to or concurrent with the client's settlement and
- the guidelines of the settlement annuity's issuer must be adhered.

What is the trade-off for the tax benefits? The structured settlement benefits cannot be accelerated, deferred or pledged as security for a loan--much like structured settlements for clients. Even so, the benefits can make an attorney fee structured settlement very attractive. Before creating a structured settlement for fees, however, check with a tax advisor or CPA who is knowledgeable in this area to ensure compliance with IRS rules.

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Patrick C. Farber is an LCA Diversity Partner and Structured Settlement Broker with Ringler Associates in Southern California. He specializes in settling medical malpractice, personal injury, product liability, workers' compensation, mass torts and construction defect cases with structured settlements in court hearings, arbitrations and settlement conferences. E-mail: pfarber@ringlerassociates.com.