FINANCIAL MANAGEMENT STRATEGY:

STRUCTURING ATTORNEY'S FEES

by PATRICK C. FARBER

You've just won a big case for your client and you are anticipating a sizable fee for your good work. The question becomes: how do you best manage this income? If you are like most attorneys, the temptation is to add it to the firm's bank account and think about what to do with it later. There is another option that may be more prudent—structuring your fees.

Structuring fees enables a law firm practice to better plan for and manage cash flow by providing a steady, safe stream of guaranteed income.

The structuring fee option—receiving proceeds over a designated time or for a specified future financial need—is allowed as a result of *Childs v. Commissioner*, 103 T.C. 634 (1994), aff'd w'out publ. op., 89 F.3d 856 (11th Cir. 1996). In upholding the *Childs* decision, the 11th District Court of Appeals in 1996 held that an attorney who defers receipt of fees into future years would be taxed on the income only in the years when the income is actually received.

Structuring attorney's fees is similar, in many respects, to structuring a client's settlement payout. While the income received is tax-deferred instead of tax-free (in the case of a personal injury client's structured settlement), specific procedures must be followed in order to receive the tax benefit. Only contingency fees can be

structured. Hourly payments, received over the course of a case, cannot be structured. Attorney's fees can be structured for almost every type of personal injury contingency fee case, even if the client decides not to structure his or her settlement funds. Payments can be customized so that separate payment streams can go to individual attorneys and to the firm.

Childs made it clear that in order for fees to qualify for structuring and tax-deferred status, a fee structure agreement, outlining how the fees will be paid, must be in place prior to the completion of the case or settlement and before any "constructive receipt" of the fee payment.

This makes sense. Since contingency fees come out of the client's damages, the decision to create a structured fee must be made prior to the conclusion of the final settlement for the injured client. If fees are received by the plaintiff's attorney directly from the defendant or the defendant's insurer after the case is complete, the entire amount is fully taxable.

Tax reporting procedures must be followed carefully. Your tax advisor should have all the proper documentation.

Fee Structuring Steps

Decide whether fee structuring is right for your firm. As a case nears completion, discuss the pros and cons of fee structuring among firm partners and with your tax professional. Can the firm benefit from regular cash flow over time or to help fund retirement, or is money needed now to pay off debts, a building mortgage, or to purchase new equipment?

Run the numbers. Go over structured fee payout options, amounts, restrictions, required documentation, and procedures with a structured settlement broker.

Create the proper wording in the client settlement agreement. The settlement agreement needs to state that the attorney/firm is receiving contingency fees as payment for services and spell out how and when the fees will be paid. The agreement must be signed by the plaintiff's attorney, the client, and the opposing party.

Here is sample language to include in the settlement agreement (however, life insurance companies prefer to use their own wording):

> The claimant solely for his/her convenience directs the above payment stream(s) to be paid to (name of attorney or firm with whom claimant has a contingent fee arrangement). Claimant consents to the above-mentioned portion of the settlement obligation assigned to the assignment company, (insert name of Assignment Company once Life Company is chosen). The assignment company will purchase an annuity from (insert name of Life Company) to fund this obligation in an assignment intended to meet *Section 130* of the IRC.

The select few life insurance companies that write structured settlements for injured parties also write structures for attorney's fees. These companies offer annuities made up of highly rated investments and government securities. The defendant or defendant's insurer purchases an annuity or annuities from the life insurance company to pay for the injured party's attorney's fees. An assignment company (typically owned by the insurance company) purchases the annuity contract from the insurance carrier to fund the attorney fee obligation. The assignment company takes control of the annuity and is obligated to make payouts to the attorney or firm.

Benefits

Structuring fees enables a law firm practice to better plan for and manage cash flow by providing a steady, safe stream of guaranteed income. These payouts can begin immediately or start at a later date. A structure can be designed so that lump sums can be distributed for the purchase of a house, when a child begins college, or when an attorney retires. For law firms, the annuity payments can mean a steady stream of income during cash flow downturns. This can be especially important if a firm is contingency-fee dependent.

Since attorneys are only taxed on income from fees they receive in a given year, not on the entire amount, the annuity purchased with the fees earns interest so the attorney can earn more than the initial settlement fee amount over time.

For example, a three-person law firm is on the verge of earning $1 million in contingency fees in a personal injury case. After discussions with their accountant, the attorneys, who are in their forties, decide to receive $350,000 of the earnings in upfront cash. The remaining $650,000 is placed into an annuity. Under the structure, the firm will then receive $8,333.33 a month for five years ($100,000 per year) from the assignment company. When the three attorneys turn sixty-five, each will receive $100,000 that will help with their retirement. Because interest compounds on the funds in the annuity, the amount the firm and attorneys receive from the annuity grows from the initial $650,000 to $800,000.

In another example, a fifty-year-old sole practitioner decides to place $1.25 million of her fee into an annuity and instructs that payments be deferred for five years. After five years, the attorney will begin receiving a monthly payment of $6,800 for life, guaranteed for twenty years. Because of interest accruing in the annuity, she will actually receive $1.632 million in guaranteed benefits over twenty years with an expected benefit of $2.4 million over her lifetime.

Structuring attorney's fees can play a big role in the retirement planning of a law firm or sole practitioner. Besides better cash flow management and positive tax ramifications, structuring fees can also mean an attorney or firm can better plan for the future with a financial sense of certainty.

***Patrick C. Farber** is a structured settlements broker with Atlas Settlement Group based in Santa Ana. He works with attorneys nationally to create structured settlement annuities for physical and non-physical injury cases. He provides support and advice during all phases of the settlement process, and can be reached at pat@patfarber.com. **Enrique Sierra** is a case manager at Atlas and assisted with the article.*

This article first appeared in Orange County Lawyer, *June 2017 (Vol. 59 No. 6), p. 48. The views expressed herein are those of the Author. They do not necessarily represent the views of* Orange County Lawyer *magazine, the Orange County Bar Association, the Orange County Bar Association Charitable Fund, or their staffs, contributors, or advertisers. All legal and other issues must be independently researched.*