Attorney fee structures: A tax-planning annuity for attorneys

Learn how you can defer fees and income taxes, even if the client's settlement isn't structured.

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Using attorney fee structures, plaintiff attorneys can defer their fees and income taxes on those fees for personal injury cases as well as for many other types of cases. An attorney fee structure allows an attorney to set up a personally tailored retirement plan without the monetary and age restrictions or other drawbacks of a qualified plan. The attorney can defer taxes on his or her fees as well as the interest that it earns until the year in which a distribution is actually received from the fee structure.

Structured attorney fees work very much like a non-qualified deferred compensation plan. The taxes that would be otherwise paid on the fee earned at the time the case is settled are deferred, and that money grows without tax on the growth. When distributions are made, the entire amount distributed during a year is taxable for that year. Based upon a taxpayer's tax bracket, there may be some distinct tax advantages to entering into this type of arrangement as opposed to being taxed on the entire fee in the year it was earned and investing it after tax.

The fee structure can help a lawyer avoid the highest tax brackets by leveling off income spikes due to large fees and spreading the income out over several years. To explore the tax benefits, consider for example, the highest marginal income tax bracket for 2008 for married couples filing jointly is 35 percent on any amount over $357,700. That rate drops to 33 percent on the amount above $200,300 and below $357,700. The rate then drops to 28 percent on the amount between $131,450 and $200,300. An attorney who otherwise would have an unusually high income in 2008, but elects to spread the income over several years, avoids paying taxes in the highest bracket. Couple the tax savings with guaranteed earnings on the deferred funds, and the benefits of an attorney fee structure become very obvious.

Fee structures can be done by one attorney in a firm, without the requirement that other attorneys and employees participate, as would be the case in a qualified retirement plan. Also, there is no limit as to the amount of income deferred. By comparison, there are statutory limits to the amount one can defer in a qualified retirement plan. Even if the attorney participates in a qualified retirement plan or individual retirement account (IRA), he or she may still defer additional income through an attorney fee structure. Unlike traditional retirement plans, there is no requirement of annual deferments. An added bonus is that the attorney fee structure is exempt from creditors' claims.

When an attorney fee is earned in a personal physical injury case, including mass torts, with all payments to the claimant being eligible for exclusion from taxable income under Int. Rev. Code § 104(a)(2), or workers' compensation case under Section 104(a)(1), the same structured settlement annuities that the personal injury victim obtains can be used, and the payment options are greatly expanded. A qualified assignment is done just as in the case of the personal injury victim. Many of the traditional annuity markets require that the personal injury victim structure their recovery for the attorney to structure his fees. However, there is a movement of late to liberalize this rule as life insurance companies become convinced of the certainty of the tax treatment by the IRS. The IRS once challenged attorney fee structures, but lost in tax court and at the appellate level. (See *Childs v. Commissioner*, 103 T.C. 36, aff'd 11th Circuit, No. 95-8762.) American General, John Hancock and Hartford are three better-known life insurance companies that do offer attorney fee structures without the personal injury victim structuring their recovery.

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Attorney fee structures can also be done on fees from cases that are not personal physical injuries under Section 104 (a)(2). These include fees from cases based on claims of discrimination, sexual harassment, employment litigation, defamation, wrongful imprisonment, wrongful termination, other non-physical personal injuries including emotional distress, punitive damages, bad faith, breach of contract and construction defects, to name several. For these types of cases, periodic payment assumption reinsurance agreements or non-qualified assigned annuities are used.

Periodic payment assumption reinsurance agreements are priced like an annuity and have the same features as annuities. However, to do reinsurance, you must have a defendant that is an insurance company; a self-insured entity cannot do reinsurance. A non-qualified assignment allows assignment of the obligation from both insurance companies and self-insured entities. Allstate Life has an excellent product line for use in these types of cases.

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(*This article is not intended to provide tax advice. Consult with your personal tax professional as to the suitability of an attorney fee structure.*)

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