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What Attorneys Should Know About Fee Deferral

By **John Bair** (June 3, 2021, 1:43 PM EDT)

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With current high-profile lawsuits like those involving product liability claims stemming from the use of Johnson & Johnson talc powder and 3M Co. earplugs, any dollar amounts plaintiffs are ultimately awarded in settlement will be widely publicized and discussed. And rightfully so — monetary verdicts or settlements are a major win for those affected by any defective products.

Lawyers, however, will likely also have another dollar amount on their minds: attorney fees.

It's common knowledge that for every corporate defendant brought to justice, the plaintiff trial lawyers who went up against them have earned themselves a payday in the form of attorney fees.

But what may not be such common knowledge is the fact that the IRS has afforded contingency fee attorneys the ability to make their fees work for them with attorney fee structures. And even if you've heard of this strategy before, read on, because the fee-structuring landscape is ever-changing.

What is an attorney fee structure?

An attorney fee structure is an investment strategy that allows contingency fee attorneys to decide how and when they receive their fees.

By implementing a preplanned schedule of periodic payments, attorneys can elect to defer all or a portion of their fees, which are not taxed until receipt. Attorneys can defer an unlimited amount or portion of fees into an attorney fee structure, affording them tax advantages and income control.

For the purposes of this article, attorney fee structure, fee deferral and all variations of the like are synonymous.

Traditionally, attorney fee structures have been executed in the form of fixed indexed, traditional and/or secondary market annuities.

While these are still viable and stable options for fee structures, new options have been gaining popularity in recent years, including investment-backed structures, permanent whole life insurance and even private wealth portfolios. Each option touts unique benefits based on an attorney's personal goals.

Attorney fee structures are made possible for all contingency fee attorneys in the U.S. due to a series of court rulings in the 1990s, including the 1996 ruling in Childs v. Commissioner of Internal Revenue from the U.S. Court of Appeals for the Eleventh Circuit.

Their feasibility is based around the concept of constructive receipt — until an attorney physically receives her fees, they are not taxable as income.

In order to structure her fees, an attorney must ensure that the terms of settlement include the creation of a periodic payment obligation for some or all of the attorney's contingency fee, as well as direction for the fee to be paid into a previously established qualified settlement fund, or QSF.

As long as the money is initially directed to this fund, the attorney can plot out how and when she'd like to receive her income in the years to come.

Once the funds are issued directly into the QSF, the fee is considered deferred. And while it sits in the QSF waiting to be distributed, it can be invested and can grow tax-free.

Why should attorneys consider fee deferral?

There are countless benefits to structuring your attorney fees.

First, as mentioned above, it allows for unlimited tax deferral and, ultimately, the ability to pay less taxes. Until the money is physically received in the attorney's bank account, she is not taxed on that income. Structuring out a given fee into a yearslong payment plan enables the attorney to stay in her existing tax bracket every year and never be taxed on the gross lump sum.

Another benefit is access to professional or self-directed investment management. As the money sits in the QSF awaiting distribution, attorneys can designate a financial adviser to manage and invest the funds into a diversified portfolio made up of equity-backed assets — think Apple Inc. or Google Inc. stock, the S&P 500, etc.

A final benefit of structuring attorney fees is the prioritization of security over assets. Note that the nuances of this benefit may vary based on the protections your financial adviser puts in place. Some things to look out for include the ability to cancel or void your agreement should you ever need to, as well as protections in the case of a debt event.

Are there instances where an attorney fee structure is not advisable?

Let's start with the caveat that it is always prudent to consult with your financial adviser when exploring a new wealth management strategy. Only they — and you — know your complete financial picture and are able to make recommendations and decisions accordingly.

Next, it's important to note that fee deferral is best suited for attorneys with excess income. If you need your fees now or in the immediate future to pay off bills or pay down debts, a fee deferral or structure likely isn't for you at this time.

Structuring your fees means exchanging liquidity for tax deferral, a unique option that all attorneys should know about, but only those who are financially established can truly take advantage of it.

Finally, if you are receiving a fee that is on the smaller side and would not catapult you into a higher tax bracket for the year, it may make sense to take the lump sum instead of deferring and structuring. Remember, this is a wealth and tax management strategy and should be utilized as such.

What do you need to know when exploring attorney fee structures for yourself?

If you are receiving a larger fee, the questions you're asking should be more about what type of attorney fee structure would best help you meet your goals. It's important to identify your personal and professional aspirations and use that information to inform your decision-making.

Here are some points to consider when determining which fee structure option would best suit you:

- If you have a specific financial adviser you've used for years and love, consider a fee deferral in the form of a private wealth portfolio. With this option, you can retain your long-term financial planner and engage an administrator willing to work in professional collaboration.

- Permanent whole life insurance could be your best deferral option if you're financially established and want to begin setting aside wealth for your children and grandchildren. You can incorporate your estate plan and reap the benefits of permanent whole life insurance's dividend-paying histories.

- If you're a conservative investor with the luxury of time, consider fixed indexed, traditional or secondary market annuities as your strategy. This approach relies on advantages inherent in the marketplace, making it both a low-risk and low-maintenance wealth planning option.

In conclusion, proper implementation of attorney fee structures can help firms and their attorneys achieve long-term financial freedom, security and success. Often, the greatest barrier to adoption is lack of knowledge that this option exists.

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