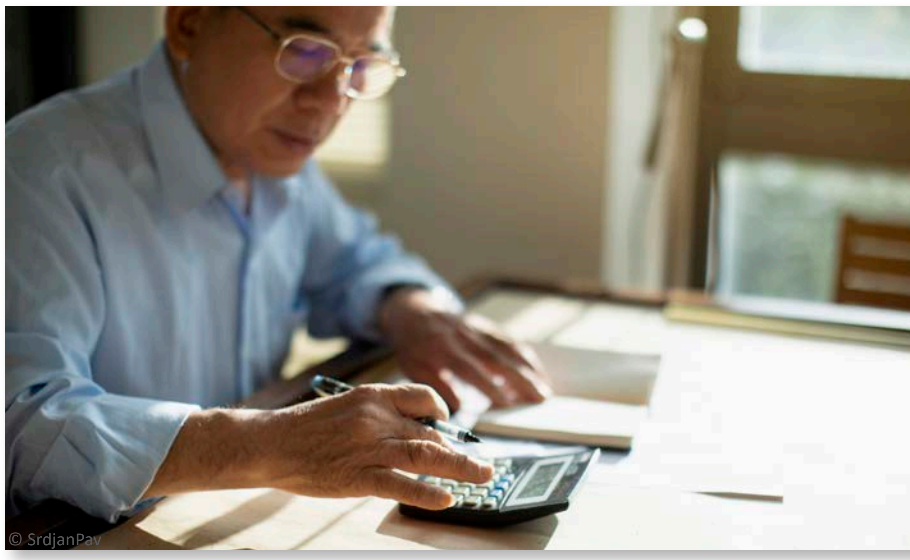
Structuring Strategies Beyond Fees

By Patrick Farber and Patrick McNulty

For years, you've structured your attorney fees. Now, you're thinking about retiring and selling your law practice. The sale can trigger a hefty tax bill. Instead, you can apply the same fee structuring strategies to the law practice sale proceeds to reduce the taxes generated by the transaction.



Structuring Fees

The ability to structure fees has been around for nearly 30 years (*Childs v. Commissioner of the Internal Revenue Service* (U.S. Tax Court 1994 103 T.C. 634, aff'd (11th Cir. 1996) 89 F.3d 856) when the IRS allowed structuring legal fees paid on contingency. When settling a case, wording is included in the settlement agreement stating that attorney fees will be structured and paid through an annuity instead of taking the fees in a lump sum. An assignment company (usually affiliated with an insurance carrier) buys the annuity, and the insurance carrier makes scheduled payments to the attorney as outlined in the agreement.

Putting all or a portion of the fees you've earned from a contingency case can have tax advantages. The funds earn tax-deferred interest while in the annuity. Only when the money is withdrawn does it become taxable. Attorneys can receive the funds on a regular schedule to better manage firm cash flow or can use the funds to pay for large expenses like college tuition or to make major purchases. Delaying withdrawal until retirement enables the funds to grow even more without immediate tax consequences.

The same structuring philosophy can be applied to structuring the proceeds from a law practice sale or sale of other assets. In insurance lingo, these are known as Structured Installment Sales.

Structuring Proceeds From A Law Practice Sale

Bill Jones is a sole practitioner who wants to sell his 40-year law practice. He finds a buyer. As part of the terms of the sale, Bill

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and the buyer agree that he will receive payments of specific amounts over a determined number of years. The buyer pays the assignment company for the purchase of the law practice and the assignment company buys an annuity with the funds

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through a life insurance company. The insurance company becomes responsible for making the annuity payments to Bill according to the payment schedule included in the sales agreement.

Why such a convoluted process? By following these steps, Bill never takes possession of the sales proceeds at the time he sells his law firm. If he had, he would owe taxes on the full amount in the year the sale was completed.

Let's say Bill sold his law practice for $3 million. Bill decides, after careful analysis and consultation with his tax advisor, that a payout schedule of monthly payments for 20 years would benefit him and his family the most. In this example, Bill would receive $19,440 every month for the 20-year duration with payments starting in January of the following year. Instead of owing taxes on the full amount in the year the sale was completed, this allows Bill to pay taxes incrementally over the lifespan of the annuity contract.

Other Structuring Options

Structuring the proceeds from the sale of a business is one type of structuring opportunity. The same process can be applied to proceeds from the sale of an investment property, a home or other personal or commercial property.

Annuities can also help with retirement planning since the annuity income is guaranteed and the interest earned on its underlying investments grows tax-deferred much like assets in a 401k account. Instructions when creating the annuity can include an inflation component so that payments are adjusted upward when the inflation rate increases.

Careful Planning Needed

Major life events can be somewhat expected (i.e., college, weddings, homebuying, retirement). When first creating the structuring guidelines, there are many options on how and when you could receive annuity payments. However, once the structured payments are in place, there is almost no ability to make changes. That's why an annuity should be just one piece of your broader financial plan. Money outside of an annuity should be set aside for emergencies. Plan carefully. ■