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House And Senate Tax Bills Bar Lawyer Tax Write-Offs For Costs

If lawyers pay for a deposition transcript, a court reporter, or travel expenses for a hearing, you might assume they can deduct them as business expenses. The same for expert witness fees. These all seem like typical business expenses for lawyers, so how could there be a problem? One question is who is bearing the impact of these expenses, lawyer or client, and when? The tax law says that business expenses must be ordinary and necessary to be deductible, but don't these qualify?

The House and Senate tax bills both say no for contingent fee lawyers, until the very end of the case when it is resolved. Under most contingent fee agreements, the client pays nothing (not even costs) unless there is a recovery. Under some fee agreements, costs are subtracted from the client's share. In others, costs are taken off the top, before the client and lawyer split the remainder. But *someone* has to pay these costs up front as they are incurred, and that is almost always the lawyer.

Lawyers understandably want to write them off right away. But the IRS has battled successfully to prevent these deductions. In fact, for plaintiff lawyers who don't want to fight with the IRS about tax deductions, the safest course is to treat costs they pay for clients as *loans* to the client. You can't deduct loans. That is painful, for it means paying the costs currently, but not deducting them on your taxes until what could be years later when the case finally resolves. Only at *that* point could you write them off.

But there was a way out in California, and throughout the Ninth Circuit, thanks to a tax case called *Boccardo v. Commissioner*, 56 F.3d 1016 (9th Cir. 1995). The Ninth Circuit court held that attorneys could currently deduct costs if they had a gross fee contract, under which the attorney receives a percentage of the gross recovery, with costs paid by the attorney taken solely out of the attorney's percentage. Any other type of fee agreement is a loan of the costs.

Some lawyers in California and other states in the Ninth Circuit went to great pains to make sure they qualified. Some lawyers may be more careless but still hope they get some protection from *Boccardo*. The IRS has long been unhappy over this issue. In fact, the IRS issued a Field Service Advice, 1997 FSA 442 (basically a memo to IRS personnel) stating that it would not follow *Boccardo* except in the Ninth Circuit.

The IRS has long wanted uniform tax treatment, and now so does Congress. Both House and Senate tax bills say no to deductions, even in the Ninth Circuit. Thus, the more favorable Ninth Circuit rule will probably change. Lawyers should consider anticipated costs, and should consider what kind of fee agreement they want to use. In the Ninth Circuit, that decision up to now has been heavily influenced by taxes. But that may soon change. Plaintiffs' lawyers in most of the country won't feel the burn, for they have had this rule for years now.

The House version of tax reform, the Tax Cuts and Jobs Act, includes a provision that bars contingency fee lawyers from deducting case-related expenses before cases are resolved: "No deduction shall be allowed … for any expense paid or incurred in the course of the trade or business of practicing law, and resulting from a case for which the taxpayer is compensated primarily on a contingent basis, until such time as such contingency is resolved." The Senate proposal explains that it "denies attorneys an otherwise-allowable deduction for litigation costs paid under arrangements that are primarily on a contingent fee basis until the contingency ends." Estimates say that this provision will save an estimated $500 million over 10 years.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.