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Calling All Class Action Attorneys





Most contingent fee attorneys are accustomed to the feast or famine nature of their business... It doesn't have to be that way.

Why not take a few minutes to plan for those “downturns” in the cycle and alleviate some stress and uncertainty? It's really very simple, and it only takes a little planning to ensure you have options once your case finally resolves.

When I say “options,” I'm referring to the manner in which you receive your contingent fees – lump sum or payments over time. More and more firms traditionally focused on personal injury and product liability litigation are diversifying their practices by engaging in securities, wage and hour, consumer protection, and other types of class action work. Just like all other contingent fee attorneys, class action attorneys have the unique ability to defer their income (and associated tax liability) into the future.

This white paper is not focused on the underlying tax law and related principles that support the concept of contingent attorney fee deferral – I'll leave that to the leading tax attorney in the field. Robert Wood's article “Can Class Action Attorney Fees be Structured?” does a wonderful job of walking through the tax principles and related support. This article can be found on our website at www.brook-hollow.com/resources.

The key takeaway is to plan ahead to ensure you have the option of taking your fees in a lump sum or in payments over time. Having the right language in any settlement agreement and/or court order that provides the necessary flexibility for attorneys is critical. A 468B Qualified Settlement Fund is also highly recommended to ensure efficiency and flexibility for all attorneys involved.

Now, let's get to the heart of this article... Assuming you are proactive and take the steps necessary to preserve your “options,” there are many ways in which you can leverage tax deferral.

Let me list a few of the most common reasons people defer receipt of their fees into the future:

1. Push Tax Obligations to Future Years;
2. Smooth Out Income (create payment streams to cover basic overhead);
3. Plan for Retirement (tax deferral is nothing more than an unlimited 401K with more flexible investment options and almost none of the restrictions);
4. Become Your Own Bank (by using deferral coupled with a loan);
5. Leverage the Government's Money to Grow Your Practice.

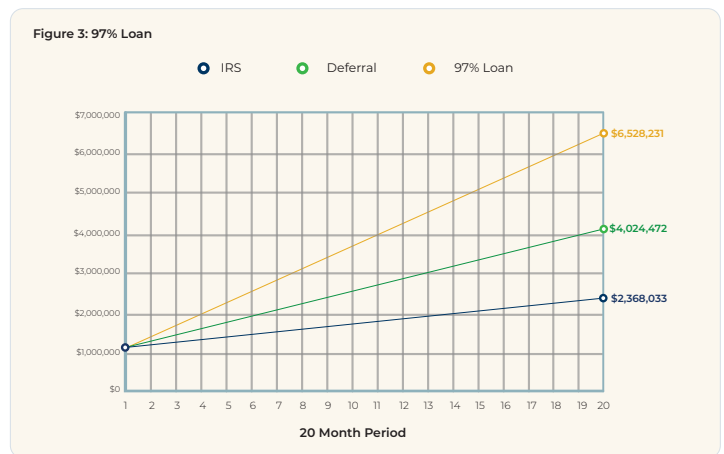
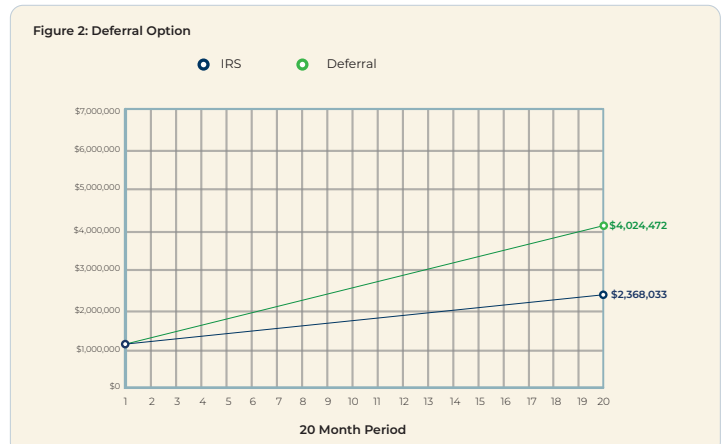
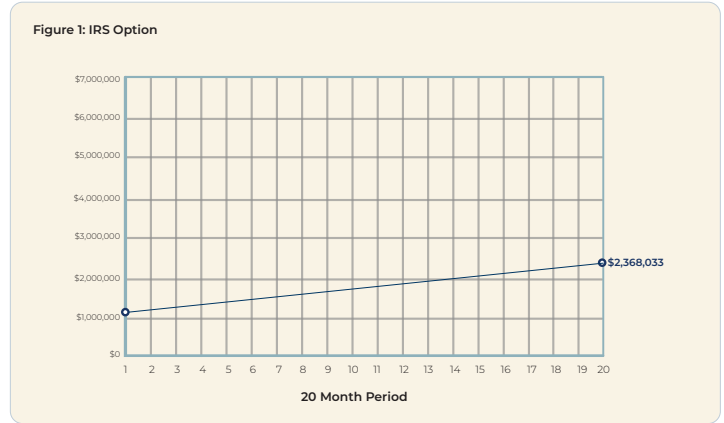


I'm a visual learner, and I suspect you may be as well. Let's look a typical situation where attorneys take their money (\$2MM in this example), pay their taxes, and use what's left after taxes (see figure 1 at right). Here, we assume a 48% income tax rate (inclusive of State and Federal), a 40% investment tax rate, and a 7% annual return.

Now, let's take a look at a simple attorney fee deferral of that same \$2MM fee. Keep in mind, there are many ways to analyze these transactions, but I'm trying to demonstrate an "apples to apples" comparison (see figure 2 at right). Here, we again assume a 7% annual return on your deferred fees.

As you can start to see, the power of deferral can be immense. Let's take it one step further. Assume you are able to defer your fees, then turn around and borrow at 2.25% interest, using your deferred fees as a source of repayment on the loan (not as collateral, which is an important distinction). Hang in there with me, because it may sound complicated and too good to be true, but it's not.

Let's assume you can borrow up to 97%¹ of the value of your tax-deferred fees (over time) and invest those (pre-tax) dollars (loan proceeds) back in your practice. And, let's assume that the typical return on investment in your practice is 15%. You can use whatever assumptions you would like, but in my experience contingent fee attorneys are looking to make significantly more than 15% on the money they invest in their practice (see figure 3 at right).



¹ Loan amounts and interest rates vary by transaction and are subject to review and approval based on individual applications.



Okay, I'll stop there with the generic examples. Just imagine having access to affordable capital when you need it for that next big case. If you don't need it, leave it in the deferral account where it's invested and growing tax-deferred to be paid to you in the future. Your ability to borrow doesn't ebb and flow like a traditional line of credit with a bank. Because you have a contractual right to receive future payments from the deferral, which can't be accelerated or assigned, those funds will be there to serve as a source of repayment on the loan. Now imagine the rate on the loan is fixed for the entire life of the transaction!

Assuming you now understand the basics of attorney fee deferral (and the option of borrowing), it may be helpful to explore a common example of how firms first implement these tools into their practice. The majority of class action firms have incurred significant debt to finance their cases. Often times, that debt is extremely expensive (upwards of 18% or more annually). Once fees finally roll in, you not only have to pay back the lender, but you also have to pay taxes on those fees. This can leave you with little to nothing in your pocket, and may even leave you in the red. Once again, it may help to see how this plays out visually (see figure #4 at right).



Given the uncertainty as to duration and value of any class action you may undertake, the peace of mind offered by the combination of tax-deferral and the loan can be the strategy you've been looking for to transform your practice. Take the time to explore your options, implement the necessary logistics, and give yourself the opportunity to control, rather than be controlled by the financial limitations in your practice.



For more information or to set up a personalized consultation please contact our team at info@brook-hollow.com.

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Tate Johnson obtained his degree in Finance from The Ohio State University and obtained his law degree from Roger Williams University School of Law. Tate spent five years as a Director at Garretson Resolution Group providing settlement administration solutions to plaintiff attorneys. Tate is a member of the Ohio Association for Justice, as well as the Cincinnati Bar Association, Ohio Bar Association and the American Association for Justice.

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