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Panel Name: The Curse of the Billable Hour: Are You Ready for Alternative Fee Arrangements?

Committee Name: Tax Practice Management

Outline: Alternative Fee Arrangements [\[FNa\]](#)

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**ALTERNATIVE FEE ARRANGEMENTS**

**ABA Section of Taxation 2016 May Meeting**

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## A. INTRODUCTION

Attorneys traditionally and typically charge by the hour but this is increasingly changing. Alternative billing arrangements vary and can get fairly creative limited by practicality, ethics and what your firm will permit.

## B. TYPES OF ARRANGEMENTS

### 1. Contingent or Success Fee: Based entirely on the results achieved.

a. Fee agreement should spell out what is considered a success and what is not, as well as the structure for calculating payment due upon success.

b. Fee agreement should also specifically discuss costs and expenses that are not contingent, such as court filing fees.

c. Attorneys should still keep track of time for these matters in case there is a dispute as to the fees earned or if the attorney is terminated before the matter is completed. Usually the attorney needs to be discharged for no cause in Maryland. If discharged for cause, it is possible the fee will not be earned.

d. Pros & Cons:

i. Attorney assumes risk of non-successful outcomes.

ii. However, attorney may receive greater payment than hourly rate in the event of successful outcome.

iii. Time keeping is still required.

e. Consider using:

i. Popular in litigation context.

ii. Used in tax refund litigation. Need to define "refund" to include IRS applying refund to other Federal debt in fee provision. Cannot require IRS to pay refund to attorney. What about tax deficiency litigation - percentage of savings achieved. Need to define starting and ending point well. Possible collection problem for attorney. What about ancillary impact - savings on state income taxes. When is fee due? What if refund claim paid is later audited?

iii. Transactional matters - If source of funds to pay attorney is completion of transaction (paid out of closing), consider including success fee. If practically client is waiting to pay you from closing, the risk is one sided on a straight hourly fee arrangement. Does success fee raise any securities laws issues?

f. Example Provision - Give client option in engagement letter for tax litigation matter

**Fee** - Select one of the following two options:

\_\_\_\_\_ a) Fees billed by the hour and due within 30 days of billing at the rate of \$400 per hour. If you select this option, I require a \$5,000 retainer prior to commencing this matter.

\_\_\_\_\_ b) Contingency fee only of 1/3 (One-Third) of the amount of income tax and interest and penalties thereon (collectively, "Tax Refund") refunded by the IRS, if any, at the conclusion of this matter. You will be considered to have received a Tax Refund if the IRS sends you a refund or applies the Tax Refund to a Federal liability you have. If no Tax Refund is obtained, no fee is due. The fee due under this paragraph is due within 10 days of obtaining the Tax Refund from the IRS and, if delinquent, shall bear interest at 0.75% per month late. Out-of-pocket costs in this matter shall be

paid by me and will not impact the fee due hereunder. This contingency fee percentage and provision are not set by law and may be negotiated by us prior to your signature on this letter. Any legal services I provide you outside of the scope of this matter not covered by this contingency fee provision and must be paid separately.

Client must select type of fee agreement prior to any work beginning.

2. Fixed or Flat Fee: The entire engagement or portion of services will be performed at a fixed or flat rate.

- a. Fee agreement should expressly provide what is covered under the flat fee and what is not.
- b. Even if the entire engagement is covered under the flat fee, spell out costs that client will be expected to cover over and above fee, like mailing or excess printing/copying.
- c. Pros & Cons:
  - i. Attorney risks a shortfall if engagement requires more time than hourly rate.
  - ii. Client also bears risk if their matter took less time than client matters of similar nature.
- d. Consider using:
  - i. Basic estate planning documents: Powers of Attorney, Advance Directives for Health Care, basic Will and Revocable Trusts. The work must be definable and typical for a flat fee to work.
  - ii. IRS collection work - obtain installment agreement, prepare an offer in compromise but must define scope of flat fee work. Example, \$2,500 to prepare and file offer in compromise then charge hourly if rejected and is appealed. Set out what client is expected to do if have flat fee provision (e.g., complete and provide Form 433-A with required substantiation). Be Cautious to also ensure that defined work is reasonable for fee. (Ethical consideration)
  - iii. Tax litigation - Flat fee impractical given unknown and variable amount of time required.
  - iv. Business transactions - Most clients underestimated the amount of attorney time required on a business deal for a flat fee to acceptable by both sides. Take into consideration a flat fee for initial preparation and then changes or negotiations should be done at an hourly rate.
- e. Retainer Language
- f. Retainer Language should be specific as to which documents are to be prepared. Do not state something general such as Estate Planning Documents. State specifically Financial Power of attorney. Or in transaction work drafting of operating agreement.
- g. Retainer must also state when fees are earned. Some states allow fees to be earned and placed into the operating account upon receipt of the retainer. In some cases it is important to state fees earned upon receipt of drafts, on final, or at signing.
- h. The retainer agreement should also state the attorney's hourly rate for these services and time should still be kept. Therefore, if the services are terminated prior to the completion of the documents required under the retainer, then the attorney has a way to still be paid.

3. Task or Unit-Based Billing: In this arrangement, identified tasks or components of the transaction are used to measure the fee. This arrangement may also be used in complex litigation or transactional matters where budgeting is required by the client.

- a. Engagement letter should recite the costs of each specific task which may be performed.
- b. Pros & Cons:
  - i. Attorney risks a shortfall if engagement requires more time than hourly rate, however, unit billing should compartmentalize risk better than pure fixed fee billing.
  - ii. Client also bears risk if their task took less time than it generally takes to perform that specific task.
- c. Consider using:
  - i. Administration of certain trusts, such as preparing Crummey letters or preparing gift tax returns.

4. Percentage Fee: Based on a schedule of fees related to the amount involved in the matter being handled. Percentage may be constant or graduated.

a. Fee agreement should provide method in which percentage is calculated, as well as any extra costs not covered by the fee.

b. Pros & Cons:

- i. Clients has a framework to estimate overall costs.
- ii. Attorney may receive shortfall if effort required exceeds percentage amount.

c. Consider using:

i. Consider using in estate or trust administration context, e.g., trust administration based on a percentage of the asset value. However, check your specific jurisdiction to ensure you are not violating any statutory fee framework.

5. Statutory or other Scheduled Fee: In some instances, the amount to be paid for legal services is spelled out in some statutory enactments, scheduled for prepaid legal service plans or by purchasers of legal services on a volume basis. Sometimes these are imposed, sometimes they are negotiated.

a. Fee agreement should provide statutory matrix or other schedule, as well as any costs that are extra and will be forwarded on to client.

b. Pros & Cons:

- i. Clients has a framework to estimate overall costs.
- ii. Attorney may receive shortfall if effort required exceeds amount allowed to be charged by statute.

c. Consider using:

i. Arises often in estate administration context. Check your specific jurisdiction to determine whether a statutory rate or commission is provided.

6. Blended Hourly Rate: One rate is applied to all hours billed on a matter regardless of whether it's for a partner, associate or paralegal.

a. Engagement letter should list all individual billable hour rates, as well as the blended rate to be charged.

b. Pros & Cons:

- i. Client may receive more attention from more experienced partners.
- ii. If a more senior attorney spends more time than a less experienced attorney or vice versa, hours for attorney may not meet the need.

c. Consider using:

- i. Generally makes sense in a larger firm context, where many individuals are involved in a single client matter.
- ii. Depends on the type of work and the amount of time it will take for an experienced attorney to complete as opposed to a less experienced attorney.

7. Fee Collars: This means hourly rates with maximum and minimum fees quoted.

a. Fee agreement should set the minimum and maximum, as well as spell out any costs that will be passed to the client above the maximum.

b. Pros & Cons:

- i. Provides predictability and cost containment to the client, while providing both fair and reasonable incentives to the attorney.
- ii. However, there is a potential shortfall for attorney.

c. Consider using:

- i. Basic estate planning documents; retitling assets to trusts.
- ii. Cap on fees can be used in any type of matter - eases client's concerns but must define scope of matter very well and be clear work outside of the scope is not subject to cap. For example, hourly fee arrangement on IRS offer in compromise matter could agree to cap on fees but make it clear that if matter goes to IRS Appeals cap does not apply.
- iii. Also consider a reduced fee once the cap is met. This way each party walks away feeling as if they are receiving something no matter what.

8. Fixed Fee plus Hourly: A portion of the matter may be charged on a fixed or flat-fee basis, and a portion charged on an hourly rate basis, because parts of the engagement cannot easily be defined.

a. Engagement agreement should state what is covered under the fixed fee and what will be over and above the fixed fee, subject to hourly rate.

b. Pros & Cons:

i. Measure of predictability for the client and attorney may limit his risk for parts of the engagement that not as predictable.

ii. However, potential that attorney will not be fully compensated for efforts.

c. Consider using:

i. Drafting estate planning documents on a fixed fee, but hourly for client meetings.

ii. Estate administration on a fixed or statutory fee, but hourly in the event of an audit.

9. Fixed Fee plus Success Fee: This hybrid is used when the firm has a good understanding of the services required and the client and the lawyer are willing to share in the risks associated with the matter.

a. Engagement agreement should state is covered under the fixed fee, as well as define what will be considered a success and amount of the success fee.

b. Pros & Cons:

i. Measure of predictability for the client and some assurance for the attorney that he will not experience great loss.

ii. However, potential that attorney will not be fully compensated for efforts.

c. Consider using:

i. Tax collection matters - Fixed fee for offer in compromise plus additional fee if offer is accepted. Need to clearly define success - what if IRS counters offer a higher (but acceptable) amount? Many offers are returned during process for non-compliance by taxpayer - risk to attorney if agree to success fee.

10. Hourly Rate plus Contingency: A portion of the fee will be hourly (possibly at a reduced rate), and a portion is based on the result received.

a. Engagement agreement should will be billed at the hourly rate, what the rates are, as well as define what will be considered a success and method of calculating the contingency fee.

b. Pros & Cons:

i. The lawyer will be guaranteed at least a minimum amount.

ii. However, potential that attorney will not be fully compensated for efforts in the event of a non-successful outcome.

c. Consider using:

i. Representing beneficiaries in will/trust contexts.

ii. Tax collection matters - Same concerns as with Fixed Fee plus Success Fee above.

iii. Tax litigation matters - Similar concerns as with straight contingency fee provision but lessens some risk to attorney - trade less upside for less downside. Often a good compromise.

## C. ETHICAL CONSIDERATIONS

### Model Rule of Professional Conduct 1.5: FEES

(a) A lawyer shall not make an agreement for, charge, or collect an unreasonable fee or an unreasonable amount for expenses. The factors to be considered in determining the reasonableness of a fee include the following:

(1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;

(2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;

(3) the fee customarily charged in the locality for similar legal services;

(4) the amount involved and the results obtained;

(5) the time limitations imposed by the client or by the circumstances;

(6) the nature and length of the professional relationship with the client;

(7) the experience, reputation, and ability of the lawyer or lawyers performing the services; and

(8) whether the fee is fixed or contingent.

(b) The scope of the representation and the basis or rate of the fee and expenses for which the client will be responsible shall be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation, except when the lawyer will charge a regularly represented client on the same basis or rate. Any changes in the basis or rate of the fee or expenses shall also be communicated to the client.

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. A contingent fee agreement shall be in a writing signed by the client and shall state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal; litigation and other expenses to be deducted from the recovery; and whether such expenses are to be deducted before or after the contingent fee is calculated. The agreement must clearly notify the client of any expenses for which the client will be liable whether or not the client is the prevailing party. Upon conclusion of a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and, if there is a recovery, showing the remittance to the client and the method of its determination.

(d) A lawyer shall not enter into an arrangement for, charge, or collect:

(1) any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or upon the amount of alimony or support, or property settlement in lieu thereof; or

(2) a contingent fee for representing a defendant in a criminal case.

(e) A division of a fee between lawyers who are not in the same firm may be made only if:

(1) the division is in proportion to the services performed by each lawyer or each lawyer assumes joint responsibility for the representation;

(2) the client agrees to the arrangement, including the share each lawyer will receive, and the agreement is confirmed in writing; and

(3) the total fee is reasonable.

**APPLICATION IN TAX-RELATED FIELD:**

**1. Lawyers can violate MRPC 1.5 if they accept fees without a court order, if one is required. This is particularly true in estate administration context:**

- a. *Disciplinary Council (Statewide Grievance Comm.) v. Smigelski*, 2009 Super. LEXIS 2339.
- b. *In re Bach*, 966 A.2d 350 (DC 2009).
  - i. Lawyer was serving as fiduciary.
- c. *In re Soininen*, 889 A.2d 294 (DC 2005).
  - i. Lawyer was serving as fiduciary.
- d. *Iowa Supreme Court Atty. Disciplinary Bd. v. D'Angelo*, 710 N.W.2d 226 (Iowa 2006).
- e. *Atty. Griev. Comm'n. v. Kendrick*, 943 A.2d 1173 (Md. 2008)
  - i. Lawyer was serving as fiduciary.
- f. *Disciplinary Counsel v. Hoskins*, 891 N.E.2d 324 (Ohio 2008).
  - i. Lawyer as fiduciary.

**2. Lawyers have frequently violated MRPC 1.5 by charging unreasonable fees in estate planning and administration:**

- a. Estate/Trust Administration
  - i. *In re Estate of Johnson*, 119 P.3d 425 (Alaska 2005).
  - ii. *In re McCann*, 894 A.2d 1087 (Del. 2005).
  - iii. *In re Engel*, 177 P.3d 502 (Mont. 2008).
  - iv. *State ex rel. Counsel for Discipline v. Widtfeldt*, 716 N.W.2d 68 (Neb. 2006).
    - 1. Percentage fee based.
  - v. *In re Wilmeth*, 647 S.E.2d 185 (S.C. 2007)
    - 1. Lawyer as fiduciary.
- b. Estate Planning
  - i. *Toledo Bar Assn. v. Johnson*, 903 N.E.2d 306 (Ohio 2009).
  - ii. *Toledo Bar Assn. v. Sawers*, 903 N.E.2d 309 (Ohio 2009), related to above case.
  - iii. *Lawyer Disciplinary Bd. v. Ball*, 633 S.E.2d 241 (W.Va. 2006).

**Circular 230**

(a) Contingency Fee Prohibition. Circular 230's prior prohibition/restriction on contingency fees added in 2007 (Section 10.27(b)) was invalidated in 2014 by the DC District Court in *G.L. Ridgely, Jr. v. J.J. Lew*. The IRS announced it is not appealing this decision. Therefore, Circular 230 does not prohibit attorneys entering into contingency fee arrangements for refund claims and tax litigation.

(b) Query - what is left of Circular 230 with respect to fees now that the restriction on contingency fee provisions has been invalidated? Section 10.27(a) states practitioners may not charge an "unconscionable" fee in connection with any matter before the IRS.

**D. STATE LAW**

1. States may have their own laws and/or bar rules governing fee arrangements that attorneys must consider.

(a) California.

(i) California Rule 4-200 of Professional Conduct governing fees is similar to ABA Model Rule reasonable.

(ii) Article 8.5 (Section 6147 et seq.) of the California Business and Professions Code governs attorneys' fee agreements and sets out very specific requirements for contingency fee agreements such as: the fee agreement must be in writing,

the attorney must provide the client with a copy of the fee agreement, a statement as to how disbursements and costs incurred in connection with the prosecution or settlement of the claim will affect the contingency fee and the client's recovery, a statement as to what extent, if any, the client could be required to pay any compensation to the attorney for related matters that arise out of their relationship not covered by their contingency fee contract, a statement that the fee is not set by law but is negotiable between attorney and client. If any of these requirements are not met, the client may void the fee agreement and the attorney is only entitled to be paid a “reasonable fee” for his or her work. Courts have fairly strictly applied these rules. For example, in one case a fee was held voidable because the contingency fee provision did not state the fee was not set by law and could be negotiable even though the attorney shows the court the fee was *actually* negotiated between the attorney and client. See [Fergus v. Songer \(2007\) 150 Cal.App.4th 552](#). In [Arnall v. Superior Court \(2010\) Cal.App4th 360](#), the court held a success fee in a transaction/tax advice matter was governed as a contingency fee and voidable for failing to meet [Section 6147](#). Thus, if any part of a fee is contingency up an outcome, comply with [Section 6147](#).

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