Contingency Fees in Tax Matters
TOPICS

- Introductions
- Basic rules
- Recent case law affecting 10.27
- Specific situations/problems that often arise
(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 an 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.
Rule 1.5 (cont’d)

(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.
(a) In general. A practitioner may not charge an unconscionable fee in connection with any matter before the Internal Revenue Service.

(b) Contingent fees —

(1) Except as provided in paragraphs (b)(2), (3), and (4) of this section, a practitioner may not charge a contingent fee for services rendered in connection with any matter before the Internal Revenue Service.

(2) A practitioner may charge a contingent fee for services rendered in connection with the Service’s examination of, or challenge to —

   (i) An original tax return; or

   (ii) An amended return or claim for refund or credit where the amended return or claim for refund or credit was filed within 120 days of the taxpayer receiving a written notice of the examination of, or a written challenge to the original tax return. [NB: This language was modified by Notice 2008-43-1.]

(3) A practitioner may charge a contingent fee for services rendered in connection with a claim for credit or refund filed solely in connection with the determination of statutory interest or penalties assessed by the Internal Revenue Service.

(4) A practitioner may charge a contingent fee for services rendered in connection with any judicial proceeding arising under the Internal Revenue Code.
(c) Definitions. For purposes of this section —

(1) *Contingent fee* is any fee that is based, in whole or in part, on whether or not a position taken on a tax return or other filing avoids challenge by the Internal Revenue Service or is sustained either by the Internal Revenue Service or in litigation. A contingent fee includes a fee that is based on a percentage of the refund reported on a return, that is based on a percentage of the taxes saved, or that otherwise depends on the specific result attained. A contingent fee also includes any fee arrangement in which the practitioner will reimburse the client for all or a portion of the client’s fee in the event that a position taken on a tax return or other filing is challenged by the Internal Revenue Service or is not sustained, whether pursuant to an indemnity agreement, a guarantee, rescission rights, or any other arrangement with a similar effect.

(2) *Matter before the Internal Revenue Service* includes tax planning and advice, preparing or filing or assisting in preparing or filing returns or claims for refund or credit, and all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer’s rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing and filing documents, corresponding and communicating with the Internal Revenue Service, rendering written advice with respect to any entity, transaction, plan or arrangement, and representing a client at conferences, hearings, and meetings.
Loving v. IRS, 742 F.3d 1013
(D.C. Cir. 2014)

- Loving and other plaintiffs were returns preparers **not** CPAs, attorneys, or enrolled agents.
- They sued to enjoin application to them of the return preparer testing, CPE, and competency requirements that IRS had promulgated in Circular 230 as part of their new return preparer regulation program (“the Regulations”).
- Theory: “return preparation” isn’t “practice before the Treasury,” and “preparers” aren’t “representatives”.
- The D.C. Circuit agreed and invalidated the return preparer regulation program.
Ridgely and his accounting firm (Ryan LLC) prepare “ordinary” refund claims (claims not on original returns, but before any IRS audit notice).

They argued that preparing such claims is not “practice before the IRS,” and thus that the IRS could not regulate the kind of fees they charged, in particular the Cir. 230 §10.27 restriction on “contingent” fees.

The District Court followed Loving and held that preparation of “ordinary refund claims” is not “practice before the IRS” either.

This ruling was practically compelled by the logic of Loving.

Ergo, the Court concluded that, the IRS cannot regulate Ridgely’s contingent fee arrangement with his client either.
The effect of Loving and Ridgely is that return preparation is not within the group of activities constituting “practice before” the IRS.

But if “practice before” the IRS means only actual representation of taxpayers in controversies (audits, rulings, collection, appeals, etc.), even by persons (CPAs and attorneys) who are otherwise practitioners, then what happens to rules (and OPR’s authority) re:

- Contingent fees on original returns?
- Contingent fees in the course of representations before Exam or Appeals or Collection?
Some states don’t require this

Should it be in the engagement letter or separately?

What about addenda sheets with other “standard terms and conditions”?

What should be covered?
- Hourly rates, increments
- Billing and payment procedures
- Retainers
- Contingent fees
Unreasonable/unconscionable fees

- What are they?
- Does this ever come up in an hourly rate situation?
- What is the effect of reductions by courts
- Generally does not lead to discipline alone
When are they permissible? What kind?
- Mere preparation of original returns—arguably allowable under the combined reasoning of *Loving* and *Ridgley*
- Services in connection with examinations/challenges to original returns—allowed under §10.27(b)(2)(i)
- Mere preparation of ordinary claims for refund or credit—allowed under *Ridgley*
- Services in connection with examinations/challenges to amended original tax returns or amended claims for refund or credit—allowed under §10.27(b)(2)(ii) as clarified by Notice 2008-43. There is an open question if the amendment occurs more than 120 days after the IRS issues the notice of examination or other challenge.
When are they permissible? What kind?

- Services in connection with claims for credit/refund of statutory penalties or interest – allowed under §10.27(b)(3)
- Services in connection with whistleblower claims under I.R.C. §7623 – allowed under §10.27(4) as added by Notice 2008-43
- Services in connection with any judicial proceeding arising under the I.R.C. – allowed under §10.27(5) as renumbered by Notice 2008-43
- Services involved with giving written tax advice– arguably allowed under the combined reasoning of Loving and Ridgley
- Services in connection with collection matters – NOT allowed under the general (b) rule
Contingent fees (cont’d)

- Other issues
  - Excessive percentages
  - “Success fees” or “The Bump” [not the dance...]
Can you use different rates for different situations?
- Premium v. regular v. discount rates
- “Difficult” clients or subject matters
- Clients who can’t pay
Third-party payor situations

- Typical situations
  - Insurers
  - Family members
  - Corporations for employees

- Issues: Conflicts
  - Conflicts
  - Privilege
  - Engagement letter terms
Alternative fee arrangements

- Typical versions
  - Flat fees
  - “Piece of the deal”

- Issues:
  - Conflicts
  - Reasonable v. unreasonable/unconscionable
  - Engagement letter terms