HYPOTHETICAL EXAMPLE: A 50-year-old attorney represented a client in a personal injury court case. The client settled the case and as a result the attorney is due $1,000,000 as a contingent fee. In this hypothetical example, the attorney typically has four options to consider:

OPTION 1: Take the full $1,000,000 up front and pay all the taxes this year. Upfront taxes would include Federal and state ordinary income tax as well as FICA. This may create an effective tax rate of about 58%.

OPTION 2: Structure the contingent fee and create an immediate stream of income. If the income is started within 30 days, the attorney would receive $105,548 per year for 10 years based on current rates. If no other income is earned each year and taxes remain the same, the effective tax rate would be about 31%. The attorney would net $1,055,480 which has an annualized return of 0.54%. If the attorney were to pass away before the 10-years of payments has concluded, his beneficiary could continue the payments.

OPTION 3: Structure the contingent fee and create a deferred stream of income. If the income is started 10 years from now, the attorney would receive $158,709 per year for 10 years based on current rates. If no other income is earned each year and taxes remain the same, the effective tax rate would be about 33%. The attorney would net $1,587,090 which has an annualized return of 2.34%. If the attorney were to pass away before the 10-years of payments has concluded, his beneficiary could continue the payments.

OPTION 4: Structure the contingent fee into a Fixed Index Annuity to capitalize on returns in addition to creating a deferred stream of income. If the income is started 10 years from now, the attorney would receive $96,523 per year for life based on current rates. If no other income is earned each year and taxes remain the same, the effective tax rate would be about 31%. If the attorney lives until age 85, he would net $2,413,075 which has an annualized return of 2.55%. When the attorney passes away, if there is money left in the account value it would be paid as a lump sum to his beneficiary. The account value grows based on indexed gains minus any income payments.

The benefits of structuring a contingent fee is that payments are secured by a highly-rated insurance company, taxes are deferred and, if certain tax rates are reduced or eliminated, the client would benefit from potentially lower taxes. In addition, structuring a contingent fee could set up income for retirement as well as protect an attorney’s beneficiaries in case the attorney were to pass away.