Doctors fighting tax deduction for lawyers

Say it will prompt filing of meritless med-mal lawsuits

Published: 1:00 am Mon, September 13, 2010

By Christina Pazzanese

Efforts by the American Association for Justice to reverse a 15-year-old tax policy prohibiting lawyers in contingency-fee cases from deducting litigation costs as business expenses in the year in which they are incurred is drawing fire from members of the medical profession, among others.

In a Sept. 1 letter to U.S. Treasury Secretary Timothy F. Geithner, the American Medical Association and 90 other organizations, including the Massachusetts Medical Society, urged Geithner to leave the Internal Revenue Service policy intact, saying any change would give lawyers a "special tax deduction" and would serve as a "financial incentive" for trial attorneys to bring "less meritorious" cases against physicians.

The AMA maintains the deduction is "special" because it applies only to "gross fee" contingency cases, not net fee contracts.

"We think the tax policy [in place] provides one more incentive to the trial attorney to look at the claim and be much more thorough," said Charles T. Alagero, vice president and general counsel for the MMS.

The organizations also say a policy change would put lawyers in conflict with long-standing state ethics rules, as well as the American Bar Association's model rules, prohibiting trial attorneys from providing financial assistance to clients without the expectation of being repaid at the end of a case.

The letter comes on the heels of a similar entreaty in July from dozens of Republican senators who said the change would add to the federal debt.

Trial attorneys say the existing tax policy, which hits plaintiff-side personal injury lawyers the hardest, unreasonably singles out the legal profession by denying its members permission to participate in what is a standard business practice and benefit that virtually all others – including doctors – now routinely enjoy.

"We are the only people that can't deduct our ordinary and necessary business expenses in the year in which they are incurred," said Frederic N. Halstrom, a medical-malpractice plaintiffs' attorney in Boston.

Camille F. Sarrouf, former president of the Massachusetts Academy of Trial Attorneys, called the current policy "patently unfair against lawyers" and said allowing the cost for experts, tests and other expensive services to be deducted in the year in which they are incurred would "absolutely" be a benefit to trial attorneys.

Most are expected to carry hundreds of thousands of dollars in expenses for years before they can hope to see a dime in reimbursement, the Boston lawyer said.

"Like every other business, we should be able to write them off," Sarrouf said.

Currently, attorneys can take the expenses as a deduction only after the case has concluded or if they are not able to recoup their costs.

Gerald A. Gerson, a certified public accountant in Woburn, said the deduction delay creates a hardship that could have a "very significant impact" on an attorney's or law firm's bottom line since the costs are often sizeable and most attorneys are already in high tax brackets.

"It's a big deal," he said.

A political issue

The tussle over deducting case fees is a political issue that goes back to 1995, when the existing policy went into effect, Halstrom said.

The impetus was the Treasury's desire to get its hands on a piece of the huge class-action awards being handed out in the late 1980s and early 1990s, sooner rather than later, according to Halstrom. "It was a windfall [for the Treasury]."

The policy change came in the wake of a 1995 9th U.S. Circuit Court of Appeals decision, *Boccardo v. Commissioner*, which held that the plaintiff, a personal injury lawyer, could deduct the litigation costs paid by his firm under a gross-fee contingency arrangement as business expenses in the year they were incurred.

The AAJ, which is spearheading the current lobbying effort, maintains it is "exploring all avenues" to "clarify" the tax code for attorneys.

"It is no secret we have advocated that our members receive the same fair tax treatment that every other small business in the country currently enjoys," Ray De Lorenzi, communications director for the AAJ, said in a statement.

Sarrouf said the IRS currently defines money spent by attorneys on expert testimony and other trial costs prior to a case's resolution as a loan.

"Which is not true," he said. "If you lose the case, you never get it back."

According to Sarrouf and Halstrom, that definition is in direct conflict with the rules of both the Board of Bar Overseers and the Supreme Judicial Court, which prohibit attorneys from making loans to clients for case costs in contingency-fee arrangements.

Sarrouf, who once prompted the SJC to modify the model rules concerning client loans, said the opposing viewpoints on what constitutes a loan puts attorneys in the middle of an unwinnable situation. "They can't be reconciled; that's the problem," he said.

Halstrom said that discord makes little difference for law firms, which are bound first to follow federal tax laws, not state statute or professional guidelines.

"The IRS could care less. As far as they're concerned, it's a loan," he said.

Claims ‘disingenuous'

Attorneys are blasting the AMA's assertion that changing the policy will increase the number of frivolous med-mal suits brought and will cost the federal government $1.5 billion in lost tax revenue over a 10-year period, as a 2008 report by the Joint Committee on Taxation estimates.

Douglas K. Sheff, vice president of the Massachusetts Bar Association and a former MATA president, said the AMA's claim that reversing the existing policy will create an incentive for attorneys to bring more frivolous cases against doctors is off base and "disingenuous."

"That makes no sense whatsoever to me," he said. "These people have no argument and are trying to spin one out of thin air," Sheff said.

Attorneys say the policy that is in place has an ancillary chilling effect on the medical-malpractice bar: Because it creates such an onerous financial burden, it effectively prevents younger lawyers from launching their own practices.

"You couldn't start a med-mal plaintiffs' firm without significant capital behind you," said Barbara H. Buell, a medical-malpractice defense attorney at Smith & Duggan in Lincoln. "To bring a med-mal case in Massachusetts, you need to have a war chest of $100,000."

Buell said the state sees few frivolous med-mal suits in large part because of the tribunal that serves as a gatekeeper to help cull weaker cases. Plaintiffs' attorneys here usually have to rack up their most expensive costs in the very first year of a case just to ensure they meet the statute's high standard.

But Alagero said most doctors in Massachusetts don't see it that way. "They think the standard is relatively easy to meet," he said.

Meanwhile, Sarrouf said opposition to allowing lawyers to take deductions as they are incurred is part of a broad effort led by trade groups like the AMA and the U.S. Chamber of Commerce for tort reform.

"Let's make it as difficult as possible to seek redress in the courts," he said of the prevailing reform attitude.