Taxing Contingency Fee Attorneys as Investors: Recognizing the Modern Reality

Robert M. Amkraut
TAXING CONTINGENCY FEE ATTORNEYS AS INVESTORS: RECOGNIZING THE MODERN REALITY

Robert N. Amkraut

Abstract: In the 1995 case of Boccardo v. Commissioner, the Ninth Circuit changed the tax treatment of advances made by attorneys working on contingency fee arrangements. The court held that, in a specific type of contingency fee arrangement, costs paid by an attorney are deductible as ordinary and necessary business expenses. This decision not only challenges assumptions underlying decades of case law and centuries of legal ethical tradition, but it also undermines the tax accounting principle of matching expenses with related income. This Note summarizes the traditional rationales for prohibiting attorneys from deducting such costs and analyzes the Boccardo decision. The Note concludes that both the traditional tax approach to advances and the Ninth Circuit’s approach are flawed and suggests an alternative: treating the expenditures as investments.

In a typical personal injury contract, the plaintiff’s attorney agrees to pursue a claim in exchange for a percentage of the damages recovered. Typically, the attorney agrees to advance money for all direct expenses incurred in pursing the claim. The tax treatment of these advances raises novel questions: Are the advances “akin to loans” and therefore not deductible as expenses? Are they “ordinary and necessary” expenses similar to the expenses incurred by any service professional in the ordinary course of business? Or are the advances really a form of investment, made by attorneys who carefully calculate the likelihood of profiting from their investment?

The characterization of these outlays holds significant financial, tax, and ethical consequences for attorneys who use contingency fee contracts. If considered “no-interest loans,” the attorney cannot immediately deduct the outlays as expenses and effectively provides a long-term cash float to the client while earning no interest and receiving no tax benefit. If the outlays are ordinary and necessary business expenses, the attorney receives significant tax benefit by deducting the expenses as they are incurred, but recognizing the income associated with those expenses only at some future date if and when damages are recovered. If the outlays represent investments, then, in addition to raising tax issues, the attorney may violate ethical norms which traditionally have prohibited investing in a client’s claim.

Until recently, case law on this issue was settled. For over six decades, U.S. courts consistently found advances made by attorneys working under contingency contracts to be analogous to loans and therefore not deductible. Courts relied on two rationales. First, courts examined
attorneys' high probability of recovering the advances through the attorneys' careful selection of cases and limitations imposed on sums advanced. Given the high likelihood of recovery and the attorneys' confidence in repayment, courts held that the advances represented a form of loan to the client. Second, courts reasoned that even under a contingency contract, traditional legal ethics principles dictated that the client "owns" the legal action taken on his or her behalf. Although an attorney may recommend a course of action, the attorney is merely the client's agent and it is the client who decides whether to follow the advice and is responsible for the claim, including expenses associated with the claim. Because the client owns the case, courts reasoned, the client, not the attorney, owns the expenses.

Despite all precedent, the Ninth Circuit Court of Appeals recently held in Boccardo v. Commissioner (Boccardo II)\(^1\) that expenditures made by an attorney working under a particular type of contingency contract are deductible as "ordinary and necessary business expenses."\(^2\) Although the decision itself is limited to the "gross fee" arrangement, a seldom used fee structure, the decision may hold broader implications.

Part I of this Note describes contingency contracts and summarizes how courts traditionally have characterized advances as a form of loan, focusing on the "probability of recovery" of these advances and ethics. Part II examines the facts, holding, and reasoning in the Boccardo II decision and part III analyzes the decision. Part IV suggests that future courts should adopt an alternative rule for the tax treatment of advances by considering them investments. Finally, part V considers the ethical implications raised by the investment characterization approach and concludes that ethical rules, as currently applied, generally do not preclude such an approach.

I. THE TRADITIONAL DOCTRINE: EXPENDITURES ARE "AKIN TO LOANS"

As contingency fee contracts became increasingly common in the 1950s and 1960s,\(^3\) tax law responded to the challenge presented by

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1. 56 F.3d 1016 (9th Cir. 1995).
2. Id. at 1020.
3. Prior to World War II, contingency fee arrangements were much less common than today. This may be the result of ethical constraints which prevented attorneys from paying client expenses. See infra part I.C. The earliest case to address the tax treatment of attorneys in a contingency fee-like arrangement is Cochrane v. Commissioner, 23 B.T.A. 202 (1931). In a divorce action for a wealthy client, Cochrane, an attorney, deducted expenses incurred under a promise from the client to
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attorneys making expenditures on behalf of clients. In a series of rulings against attorneys, courts held that advances are not "ordinary and necessary" business expenses but rather constitute a type of no-interest loan secured by the eventual recovery. Courts based this approach on the attorneys' high probability of recovering the advances and on ethical rules prohibiting attorneys from investing in their clients' claims. The following sections examine contingency fee contracts, case law on the tax treatment of expenses incurred under such contracts, and the ethical issues underpinning contingency agreements.

A. Contingency Fee Contracts

Contingency fee contracts are the most commonly used method of compensating plaintiffs' attorneys in personal injury cases. A fee is contingent when there is "some chance that the lawyer will not receive the fee because the representation ends with an unwanted result for the lawyer's client." The most common contingency agreement provides for a "net fee." Under such an agreement, the attorney agrees to pay all expenses incurred in pursuing the claim, and the client agrees that expenses will be reimbursed to the attorney out of any damages received. In effect, the expenditures act as a lien against the future recovery. The amount by which the damages exceed expenses is then divided between the client and attorney based on specified percentages. Expenses cover direct costs incurred by the attorney related to the claim. These costs typically include filing fees, witness fees, travel, and medical consultations. Expenses do not include overhead or the value of the attorney's time.

reimburse him after the divorce was obtained. Although not a contingency fee contract as they are understood today, given the uncertainty of obtaining a divorce when he took the case, and given that his recovery of expenses was predicated on obtaining the divorce, Cochrane's position can be analogized to a modern contingency fee arrangement. The court disallowed the deduction, holding that the expenditures were not "ordinary and necessary expenses," but rather advances for which he expected to be repaid and were thus akin to loans. Id. at 207-08.

5. Id.
6. A typical agreement provides for a sliding scale with the percentage paid to the attorney increasing as a case progresses. For example, an attorney may receive 20% if a recovery is received before filing suit, 33% if recovery occurs after a suit is filed, and 40% if the case actually goes to trial.
7. Typical expenses include fees for expert witnesses, medical examinations, consultants, travel, etc.
“Gross fee” contingency agreements pay a straight percentage of any settlement amount to the attorney without separately providing for reimbursement of expenses. The percentage may be higher or lower than in a net fee agreement.

B. The “Probability of Recovery” Approach: Advances Are Not Deductible as “Ordinary and Necessary” Business Expenses

Beginning in the 1960s, contingency fee attorneys sought favorable tax treatment on advances by deducting them as “ordinary and necessary” business expenses. Section 162 of the Internal Revenue Code permits a trade or business to deduct “all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.” A substantial body of case law addresses the issue of what constitutes an “ordinary and necessary” expense. As a practical matter, an expenditure which is not deductible as ordinary and necessary must be either a capital expense or (possibly) a loan.

Determinations over whether advances are deductible have significant effects. For example, a personal injury attorney may advance hundreds of thousands of dollars in expenses in any given year. Many personal injury cases last years before resolution and complex cases may take longer. If appealed, a given case might take ten years to resolve. For an attorney in the top 39.6 percent tax bracket who advances, for example, $100,000 for client expenses, the loss of current deductibility

8. See Appellant’s Brief at 15, Boccardo v. Commissioner (Boccardo II), 56 F.3d 1016 (9th Cir. 1995) (No. 93-70850).
9. See, e.g., Burnett v. Commissioner, 356 F.2d 755 (5th Cir. 1966); Hearne v. Commissioner, 309 F.2d 431 (9th Cir. 1962); Monek v. Commissioner, 25 T.C.M. (CCH) 582 (1966).
12. “The principal function of the term ‘ordinary’ in section 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures . . . .” Commissioner v. Tellier, 383 U.S. 687, 689 (1966) (citing Welch v. Helvering, 290 U.S. 111, 113–16 (1933)). Exceptions include personal expenses, which are never deductible, and expenditures made relating to tax-exempt income.
14. Many cases discussing the deductibility issue address the length of time before a case is resolved. See, e.g., Boccardo I, 12 Cl. Ct. at 185; Burnett v. Commissioner, 42 T.C. 9, 10 (1964), aff’d, 356 F.2d 755 (5th Cir. 1966); I.R.S. Tech. Adv. Mem. 0162.00-00 (June 30, 1982).
would cost $39,600 in income taxes until the case is resolved. In addition, the attorney loses any income that would be generated by investing that money.

Cases decided in the 1960s established the probability of recovery of advanced expenses as the criterion by which to judge whether contingency fee advances could be deductible as "ordinary and necessary" expenses. In ruling against a personal injury attorney in Burnett v. Commissioner, the Fifth Circuit noted the efforts by the law firm to screen clients and the firm’s successful track record in recovering advances. The court reached this decision by first adopting the rule that "whether an expenditure constitutes an expense within the meaning of Section 162(a) must be determined by examining the circumstances and conditions under which it was made," and then finding that, based on the record, advances were "virtually certain to be repaid." The record itself revealed that Burnett carefully screened prospective clients before accepting their cases, limited his exposure by capping advances, and achieved a rate of recovery of advances exceeding ninety-eight percent. The court pointed out that Burnett’s rate of recovery of contingency advances actually might exceed recovery from more conventional clients who assumed personal liability for repayment.

Several decisions subsequent to Burnett closely followed the same reasoning. In Monek v. Commissioner, the Tax Court cited Burnett in holding that Monek was precluded from deducting advances made on behalf of contingency fee clients based on his high rate of recovery. Just three years later, in Canelo v. Commissioner, the Tax Court once again ruled against an attorney seeking to deduct advances. In addition to citing objective factors such as a high rate of recovery, the Canelo

17. Id.
18. Id. at 759–60.
19. Id. at 759.
20. Id. at 760.
21. Id.
22. 25 T.C.M. (CCH) 582 (1966).
23. Id. at 586–87. Significantly, the Monek court found the objective facts, primarily the rate of recovery, so compelling that the court declined even to consider any additional arguments made against deductibility. Thus the court did not address whether allowing expenses to be deducted was unethical or against public policy by undermining traditional notions that a client owns his or her case. Id.
24. 53 T.C. 217, 224 (1969), aff’d, 447 F.2d 484 (9th Cir. 1971).
25. Id.
court went so far as to state that mere expectation of reimbursement is enough to make expenditures "in the nature of loans" and therefore not deductible.  

The next chapter in the "probability of recovery" line of cases was the first in a series of actions brought by James Boccardo. Boccardo is a successful personal injury attorney with offices in San Jose, California, and Washington, D.C. In Boccardo v. United States (Boccardo I), he contested the Internal Revenue Service's action denying his deduction of litigation expenses for contingency fee clients. In the year at issue in the case, Boccardo claimed $290,547.00 in litigation expenditures as ordinary and necessary expenses under I.R.C. section 162. Boccardo distinguished his situation from established case law by arguing that both the practice of law and legal norms had changed. Specifically, Boccardo argued that, consistent with evolving standards of legal ethics, an attorney now could pay (as opposed to advance) client expenses. Thus, according to Boccardo, the expenditures now belonged to the attorney, not the client. The court disagreed, ruling that both the case and associated expenses remain the client's property and that "[o]nly when [the expenses] become unrecoverable do they become expenses of the law firm."  

Boccardo I demonstrated that case law in this area was unaffected by changes in legal practice. Any attempt to deduct advances would be rejected based on probability of recovery. Almost by definition, any successful contingency attorney would have a strong likelihood of recovery and therefore could not deduct advances. An attorney who did not have a strong likelihood of recovery was not likely, for obvious business reasons, to remain in practice. In short, the only attorney who might be able to deduct advances was one who could not afford to practice law. Although Boccardo I capped the line of cases prohibiting lawyers from expensing advances, it raised new considerations based on evolving legal ethics and practices.

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26. Id. at 225.  
28. Id. at 185.  
29. Id.  
30. Id. at 187.
C. Legal Ethics Underpinning the Probability of Recovery Doctrine

In addition to the "probability of recovery" rationale, hundreds of years of legal ethics and tradition underlie the cases that consistently rejected advances as ordinary and necessary expenses. Rules of professional conduct dating back to common law England state that a client is responsible for and owner of a legal claim. Just as the client owns the claim, so too the client owns the expenditures associated with the claim. Federal tax law buttresses the ethical constraint by prohibiting deductions for any payment which "subjects the payor to a criminal penalty or the loss of license or privilege to engage in a trade or business." Because violating the ethical codes as enacted in the Rules of Professional Conduct subjects an attorney to possible disbarment (a "loss of license or privilege to engage in a trade"), deductions for advances could be prohibited under this combined tax law and ethics analysis.

Concerns about lawyers "owning" cases grew out of prohibitions against maintenance and champerty which originated in medieval England. Maintenance has been defined as "improperly stirring up litigation and strife by giving aid to one party to bring or defend a claim without just cause or excuse." Champerty is a form of maintenance.

31. See Wolfram, supra note 4, § 8.13.
32. This approach appears unique to attorneys. In contingency situations not directly involving attorneys, non-attorney taxpayers have been permitted to deduct expenses associated with their contingent claims. In Alleghany Corp. v. Commissioner, 28 T.C. 298 (1957), an investment corporation, Alleghany, was allowed to deduct over $500,000 in expenses paid to help a bankrupt company owned by Alleghany fight for a more favorable valuation of Alleghany's ownership interest in the company. The expenditures were incurred under the express agreement that if the bankruptcy proceedings awarded these costs to the company and to the attorneys hired by Alleghany, then the company and attorneys would reimburse Alleghany. Id. at 301. In effect, the IRS permitted Alleghany to deduct expenses incurred in pursuing what amounted to a contingency claim in the bankruptcy court. In Electric Tachometer v. Commissioner, 37 T.C. 158 (1961), Electric Tachometer Corporation deducted moving expenses resulting from a state highway condemnation. While acknowledging that Electric Tachometer was entitled to eventual reimbursement, the court found that because the amount of reimbursement was contested, petitioner had no "fixed right" to reimbursement and therefore the expenditure did not constitute an advance against a future repayment from the state. Id at 162. The fact that a contingency fee attorney is held to a different standard than other taxpayers clearly is demonstrated by these cases. An attorney with no entitlement to any recovery may not deduct advances for client expenses. However, a corporation with an acknowledged legal claim, but where the contest is over how high the reimbursement will be, is permitted to deduct expenses pursuing that claim.
34. Wolfram, supra note 4, § 8.13.
35. Id. § 8.13 (quoting Lord Denning).
where the person assisting in the litigation (presumably the attorney) becomes an interested investor because of a promise by the assisted person to repay the investor with a share of recovery.\footnote{36} Under the common law, maintenance and champerty were criminal offenses.\footnote{37}

The rule against maintenance and champerty sought to prevent meritless claims by prohibiting attorneys from "investing" in their clients' cases.\footnote{38} A party was thought more likely to pursue a spurious claim if someone else (the attorney) paid the costs. Making the client responsible for all expenses was seen as an ethical constraint on the attorney as well as a way of reducing the amount of litigation.\footnote{39}

Early United States legal practices followed the English common law prohibitions; contingency fee agreements between attorneys and clients were considered champertous.\footnote{40} Sometime after the Civil War, individual states began permitting attorneys to advance client expenses as long as the client remained obligated to repay the advances.\footnote{41} By the turn of the century, most states permitted such advances.\footnote{42} Ethical acceptance of this practice was formalized in the \textit{Canons of Ethics} adopted by the American Bar Association (ABA) in 1908 which, grudgingly, permitted attorneys to advance client expenses.\footnote{43} The \textit{Model Code of Professional Responsibility (Model Code)}, adopted by the ABA in 1969, continued the 1908 Canons. Under the Model Code's ethical considerations, an attorney could advance expenses, but was required to hold the client personally liable for the advances.\footnote{44} An attorney therefore could not ethically make advances at his or her own risk.

As personal injury practices based on contingency fee contracts became more popular, the Model Code's restrictions came under increasing attack. Indigent clients asserted the rule discriminated against them because they could not afford to assume liability for the costs

\footnotesize{\begin{itemize}
\item \footnote{36} \textit{Id.} § 8.13.
\item \footnote{37} \textit{Id.} Maintenance and champerty remained crimes in England until 1967.
\item \footnote{38} \textit{Id.} § 9.4.1.
\item \footnote{40} Wolfram, \textit{supra} note 4, § 9.4.1.
\item \footnote{41} \textit{See id.}
\item \footnote{42} \textit{Id.}
\item \footnote{43} American Bar Association, \textit{Canons of Professional Ethics} (1908). Canon 10 prohibits a lawyer from purchasing any interest in the litigation. Canon 42, adopted in 1928, permits a lawyer to advance expenses of litigation "as a matter of convenience, but subject to reimbursement." \textit{Id.; see also} ABA Comm. on Ethics & Professional Responsibility, Formal Op. 288 (1954).
\item \footnote{44} \textit{Model Code of Professional Responsibility} EC 5-8 (1969).
\end{itemize}}

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required to pursue a claim. In some cases, attorneys simply chose not to attempt collection of advances made in unsuccessful claims. Bar associations that pressured attorneys to aggressively collect advances found themselves in the difficult position of claiming protection of public interest and legal ethics by forcing an attorney to repossess the possessions of a poor client who, in many cases, was still suffering injury related to the unsuccessful claim.

As a result of these pressures, the Model Rules of Professional Conduct adopted in 1983 enacted changes. Most significantly, Rule 1.8(e) eliminated the requirement of client liability in cases where advances exceed damages. In addition, Rule 1.8(e)(2) permits an attorney to excuse all liability for indigent clients, even if the client obtains damages.

II. **BOCCARDO II: FACTS, HOLDING, AND REASONING**

Boccardo did not appeal the Tax Court decision in *Boccardo I*. However, after consulting a tax attorney, Boccardo began using a different form of contingency fee contract—the gross fee contract. Unlike a conventional net fee agreement, the gross fee contract distributed any settlement amount based solely on specified percentages and without regard to expenses incurred and paid by Boccardo in pursuing the action. Thus, the client’s ultimate award was not affected in any way by the amount of expenses incurred.

Boccardo deducted expenses incurred under his gross fee contracts as ordinary and necessary expenses. He argued that full recovery of

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46. Hazard, supra note 39, § 1.8:602.


51. Boccardo v. Commissioner (*Boccardo II*), 56 F.3d 1016, 1017 (9th Cir. 1995); see supra part I.A.

52. The only exception to this rule is the case of a client who chooses to terminate the relationship before recovery of judgment. Under both net and gross fee contracts, a client has the option to terminate the relationship at any time. However, a client who does so is liable for the “reasonable value” of the law firm’s services. This occurs very rarely in contingency fee cases. Less than one percent of Boccardo’s clients chose this option. *Boccardo II*, 56 F.3d at 1017.
advances is less certain under gross fee contracts because, unlike a net fee contract where expenses are reimbursed before paying the attorney a contingency fee, gross fee contracts provide no priority to expense reimbursement. The IRS challenged the deductions and in the resulting case the Tax Court disallowed them. The Tax Court held: “The fact that reimbursement may be somewhat more uncertain under the gross fee agreements than under the net fee agreements is not sufficient . . . to distinguish the two types of arrangements.”

Citing Canelo v. Commissioner for the proposition that the contingent nature of reimbursement is insufficient to justify treating advances as expenses under section 162, the court held that a gross fee arrangement differed from a net fee only in “affect[ing] the degree of contingency.” The court concluded that Boccardo failed to substantially distinguish between gross and net fee contracts and, citing the line of cases capped by Boccardo I, held Boccardo’s advances to be akin to loans.

Not only did the Tax Court reject Boccardo’s attempt to distinguish gross and net arrangements on probability of recovery grounds, the court also cited the California Rules of Professional Conduct (California Rules) as an additional basis for its holding. The court noted the traditional notion, upheld by the California Rules, that a recovery belongs to the client and that an attorney may incur expenses only with the client’s permission or to advance client interests. The court rejected the argument that under a gross fee contract the client’s ownership of the claim was any less than under a net fee, an argument that if accepted would allow an attorney to assert a different and more ethically acceptable claim against the settlement amount.

Boccardo appealed to the Ninth Circuit Court of Appeals with a surprising result. Rejecting the Tax Court’s holding that gross and net fee contracts are not substantially different, and sidestepping ethical limitations on attorneys, the Ninth Circuit in Boccardo v. Commissioner

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53. Appellant’s Brief at 7, Boccardo II (No. 93-70850); see also infra part III.A.
55. Id. at 2741.
57. Boccardo, 65 T.C.M. (CCH) at 2741.
58. Id. at 2742.
59. Id. (citing California Rules of Professional Conduct Rule 5-104).
60. Id. at 2743.
61. Id. at 2742.
(Boccardo II) held that advances incurred in pursuing gross fee contingency fee claims are deductible as ordinary and necessary business expenses. While limited to gross fee contingency contracts, this decision for the first time allows deductions for advances made on behalf of clients and thus challenges the assumptions of decades of case law and hundreds of years of legal ethics.

The opinion took just two paragraphs to reject the Tax Court's probability of recovery reasoning. Finding that a gross fee arrangement could cause different economic results than a net fee agreement, the Ninth Circuit reasoned that gross fee contracts therefore could not be "governed by the automatic application of the cases decided on the basis of the net fee contracts." The court noted that the necessity of a personal injury firm paying some client costs is "axiomatic" and that such payments are "ordinary." Finally, in language that could apply equally to net fee cases, the court questioned the very basis of case law relating to advances made on a contingency contract:

It is difficult to see how the label of "advances" with its implication of "loans" can be applied as a matter of law to payments when there is no obligation on the part of the client to repay the money expended. The plain fact is that, under the gross fee contract, the firm, like other businesses, can only make a profit if it succeeds in deriving gross fee revenues that exceed its own expenses—that is, if it succeeds in keeping its own costs, including the type singled out by the IRS, lower than the fees it obtains over the course of a given year from the clients whose cases are successful.

Having rejected the probability of recovery theory as a basis for denying the deduction of advances as expenses, the Ninth Circuit then addressed ethical considerations. Once again, the opinion rejected the Tax Court holding. First, the opinion noted that Boccardo's practice in Washington D.C. faced no ethical challenge because in 1980 the District of Columbia "jettisoned" the requirement that a client is ultimately responsible for expenses. Turning then to Boccardo's San Jose practice, the court observed that California retains the old rule mandating client

62. 56 F.3d 1016 (9th Cir. 1995).
63. Id. at 1020.
64. Id. at 1018.
65. Id.
66. Id.
67. Id. at 1019.
68. Id.
liability for expenses, but that an exception is made for attorneys who advance expenses when repayment is contingent on the outcome of the case. The court then noted, with approval, that various state prohibitions against a lawyer paying client expenses had been undermined in contexts other than personal injury.

Finally, after discussing the ethical issues involved, the court found no need to even consider the California Rules in applying I.R.C. section 162 to Boccardo. I.R.C. section 162(c) prohibits deductions for any payment illegal "under any law of the United States, or under any law of a State (but only if such State law is generally enforced), which subjects the payor to a criminal penalty or the loss of license or privilege to engage in a trade or business." The court found that no federal law prohibits a lawyer from paying client expenses. While the California Rules might constitute state law, the violation of which could result in revocation of a lawyer’s license, the court found no evidence presented that they are enforced. In fact, the court found just the opposite: that there was evidence that such restrictions are not enforced. The court concluded that where there is no evidence of violation of federal or state law the court cannot use unenforced generalized ethical constraints to deny deductions. Specifically, the court stated: "The line of ethical inquiry pursued by the Tax Court ends when it becomes apparent that the criteria set by § 162(c) for disqualifying a deduction have not been met."

III. ANALYSIS OF BOCCARDO II

Boccardo II provided the opportunity for an appellate court to reconsider traditional rationales for the nondeductibility of contingency fee advances. The probability of recovery rationale, as the court correctly pointed out, is based on the tenuous logic that advances are somehow like loans even though there is no obligation to repay them. In no other

69. Id. (citing California Rules of Professional Conduct Rule 4-210(A)(3)).
70. Id. (citing Rand v. Monsanto Co., 926 F.2d 596 (7th Cir. 1991)). In Rand, the Seventh Circuit rejected New York prohibitions against lawyers paying expenses in class action cases. Rand, 926 F.2d at 601.
72. Legal ethics codes are enacted by each state’s bar and adopted by the state supreme court, thus giving the codes the force of state law.
74. Id.
75. Id. at 1018.
tax setting is a loan defined by its likelihood of repayment. The second traditional rationale, ethical prohibitions, has also been overtaken by current legal practice. As the Boccardo II court explained, these prohibitions have either been formally changed or abandoned in practice. Unfortunately, having spotted the problems in the traditional analysis of advances, the court’s subsequent analysis is incomplete and faulty.

The first flaw in the Ninth Circuit’s analysis involves a threshold matter; the finding that Boccardo’s gross fee agreement has a different “economic result” than the net fee agreements considered in prior cases. By making this finding, the court apparently found itself unconstrained by precedent. Unfortunately, the court failed to indicate just what those economic differences are. As demonstrated below, the economic differences are, in reality, minor, and are generally irrelevant to the legal issue being considered—the tax treatment of advances. In addition, the court entirely overlooked an earlier stipulation by the parties that there are no economic differences between the two types of agreements. Once beyond the economic difference threshold issue, the court concluded that if advances are not “akin to loans” then they must be ordinary and necessary business expenses. This approach ignored a fundamental principle of accounting, matching income with related expenses. It is a giant leap from finding that gross fees are economically different from net fees to holding that advances made in gross fee contracts are “ordinary and necessary” expenses under I.R.C. section 162.

76. Although “debt” is referenced in various sections of the tax code, see Bittker, supra note 11, ¶ 33-3, the only actual definition of debt is provided by the regulations-for-bad-debt section of the code: “A bona fide debt is a debt which arises from a debtor-creditor relationship based upon a valid and enforceable obligation to pay a fixed or determinable sum of money.” Treas. Reg. § 1.166-1(c) (as amended in 1986). A client advance made under either a net or gross fee contingency contract simply does not result in an “enforceable obligation to pay a fixed or determinable sum of money.” Although I.R.C. § 166 definitions do not conclusively determine whether an expenditure is a loan or a § 162 ordinary and necessary expense, Burnett v. Commissioner, 356 F.2d 755, 759 (5th Cir. 1966), it is odd to suggest that such expenditures are akin to loans but should not be evaluated by the definition of the term most similar to loan. Scholars have argued that the definition provided by § 166 should be applied to all sections of the code. See, e.g., Bittker, supra note 11, ¶ 33-3. The “debt” characterization dates back to a time when attorneys were obligated to formally require clients to reimburse the attorney for any advances made. In today’s practice of law, however, neither statute nor common sense justifies defining an advance as a loan.

77. Boccardo II, 56 F.3d at 1019.

78. Id. at 1018.
A. The Court’s Analysis of Economic Differences Between Net and Gross Fee Contracts Is Flawed and Overlooks a Stipulation That There Are No Economic Differences.

The court accepted Boccardo’s assertion that gross and net fee contracts produce different economic results and therefore must be analyzed differently. Under the well accepted tax principle that the IRS may examine the substance of a transaction rather than its form, a failure to find such a difference would, per principles of stare decisis, preclude the need for further analysis. Thus, this finding of economic difference was fundamental, as a threshold matter, to the Boccardo II holding. A close analysis of the two forms of agreements reveals that there are economic differences. Although these differences may affect dramatically which form of agreement is more profitable to the attorney, they only marginally relate to the probability of recovering advances, the central issue in the case.

As described in part I of this Note, the main difference between gross and net fee contracts is how expenses are reimbursed to the attorney. In a net fee arrangement, expenses are first deducted from the settlement and reimbursed to the attorney. The attorney then receives a contingency percentage of the remaining balance. In a gross fee agreement, the attorney receives a set contingency percentage of the settlement as payment in full. For bookkeeping purposes, the gross fee attorney then “reimburses” himself or herself for expenses advanced. Any balance remaining represents the attorney’s actual income. From the client’s perspective under a gross fee arrangement, the amount of expenses is irrelevant since the client’s “take” is not affected by expenses.

The differences between the two types of agreements are best shown by examples. As illustrated below, barring the unlikely event of settling a case without incurring any expenses, a net fee agreement will always be better for the attorney. For these examples, assume a 33-1/3 percent contingency arrangement and a settlement of $100,000. Only the costs change.

79. Id.
80. “Substance over form” is a well accepted tax principle which holds that the IRS may examine the underlying substance of a transaction, “what really happened,” rather than merely the form of the transaction.
81. For an extensive discussion of the economic differences between gross and net fee agreements, including examples of various scenarios, see Appellants Brief at 15, Boccardo II (No. 93-70850).
**Example 1:** Assume the firm incurs $10,000 in expenses in settling a case for $100,000.

<table>
<thead>
<tr>
<th></th>
<th>Net</th>
<th>Gross</th>
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<tbody>
<tr>
<td>Cost reimbursement</td>
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<td>$0</td>
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<tr>
<td>Fee payable to firm.</td>
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<td>$33,333</td>
</tr>
<tr>
<td>Net: ($100,000 - $10,000) X 33-1/3%</td>
<td>$40,000</td>
<td>$33,333</td>
</tr>
<tr>
<td>Gross: $100,000 X 33-1/3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total received by firm.</td>
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<td></td>
</tr>
<tr>
<td>Net to firm (Total received minus expenses).</td>
<td>$30,000</td>
<td>$23,333</td>
</tr>
</tbody>
</table>

**Example 2:** Assume the firm incurs $40,000 in expenses in settling a case for $100,000.

<table>
<thead>
<tr>
<th></th>
<th>Net</th>
<th>Gross</th>
</tr>
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<tbody>
<tr>
<td>Cost reimbursement</td>
<td>$40,000</td>
<td>$0</td>
</tr>
<tr>
<td>Fee payable to firm.</td>
<td>$20,000</td>
<td>$33,333</td>
</tr>
<tr>
<td>Net: ($100,000 - $40,000) X 33-1/3%</td>
<td>$60,000</td>
<td>$33,333</td>
</tr>
<tr>
<td>Gross: $100,000 X 33-1/3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total received by firm.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net to firm (Total received minus expenses).</td>
<td>$20,000</td>
<td>$(6,667)</td>
</tr>
</tbody>
</table>

**Example 3:** Assume the firm incurs no expenses in settling a case for $100,000.

<table>
<thead>
<tr>
<th></th>
<th>Net</th>
<th>Gross</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost reimbursement</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Fee payable to firm.</td>
<td>$33,333</td>
<td>$33,333</td>
</tr>
<tr>
<td>Net: $100,000 X 33-1/3%</td>
<td>$33,333</td>
<td>$33,333</td>
</tr>
<tr>
<td>Gross: $100,000 X 33-1/3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total received by firm.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net to firm (Total received minus expenses).</td>
<td>$33,333</td>
<td>$33,333</td>
</tr>
</tbody>
</table>

**Example 4:** Assume the firm incurs $300,000 in expenses in settling a case for $100,000.

<table>
<thead>
<tr>
<th></th>
<th>Net</th>
<th>Gross</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost reimbursement</td>
<td>$100,000</td>
<td>$0</td>
</tr>
<tr>
<td>Fee payable to firm.</td>
<td>$0</td>
<td>$33,333</td>
</tr>
<tr>
<td>Net: ($100,000 - $300,000) X 33-1/3%</td>
<td>$(200,000)</td>
<td>$(266,667)</td>
</tr>
<tr>
<td>Gross: $100,000 X 33-1/3%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total received by firm.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net to firm (Total received minus expenses).</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
From an attorney’s perspective, a net fee agreement is almost always preferable to a gross fee agreement. For this reason, nearly all contingency attorneys work under net fee contracts. However, the relative advantage to attorneys of net over gross fees is irrelevant to the rationale denying the availability of deductions: probability of recovery. To get beyond the economically-different threshold, an attorney seeking to deduct expenses under a gross fee contract must demonstrate that he or she is less likely to recover advances. The fact that one form of contingency agreement results in larger returns to an attorney should have no bearing on deductibility.

The only difference between gross and net fee agreements, as they relate to probability of recovering expenses, occurs in cases where expenses represent either a high percentage of recovery or exceed recovery (refer to examples two and four above). Thus, it is possible that a gross fee attorney would not recover full expenses in a case where a net fee attorney would. Barring any additional considerations, this might satisfy the threshold requirement of economic differences. In *Boccardo II*, however, there was an additional consideration: The stipulated facts in the Tax Court established that the percentage of expense reimbursement was identical in net and gross fee cases handled by Boccardo.82

In the face of this factual stipulation, it is difficult to understand exactly what relevant economic differences the Ninth Circuit found. The court’s failure to state a difference leaves the reader seeking *any* possible interpretation which demonstrates an economic difference.

There is only one possible interpretation, admittedly a strained one, under which in spite of the stipulation, an economic difference may be found. Interpreting the ninety percent recovery as applying not to actual dollars advanced, but rather to ninety percent of total cases, and assuming that the remaining ten percent includes cases where expenses represent a large percentage of the recovery (refer to examples two and four above), then it is possible to find an economic difference between gross and net fee agreements. Apparently, based on these interpretations, the *Boccardo II* court chose to upend decades of case law.

82. *Boccardo v. Commissioner*, 65 T.C.M. (CCH) 2739 (1993), *rev’d*, 56 F.3d 1016 (9th Cir. 1995) ("In a particular case, this may result in less reimbursement . . . However, the overall reimbursement of 90 percent of costs found by the Claims Court for the net fee agreements, and stipulated to here for the gross fee agreements, was the same under both types.").

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B. Allowing the Deduction of Advances Violates the “Matching” Principle of Accounting

Having found an economic difference between gross and net fee agreements, the Ninth Circuit decided to treat advances as ordinary and necessary expenses. Based on the terse wording of the opinion, it appears that the court did not consider any alternative analyses. While the traditional “akin to a loan” analysis may indeed be flawed, classifying advances as currently deductible ordinary expenses is worse because such a classification violates fundamental principles of tax accounting. A brief review of the cash and accrual accounting methods and of the principle of matching income and expenses in the same tax period illustrates the problem.

Under the cash method of accounting, expenses and income are both recognized when actually paid or received. Under the accrual method, expenses and income are recognized not when cash actually changes hands, but rather when an obligation is incurred or credit is accrued. Cash method taxpayers may find it in their interest to pre-pay expenses. By making a cash outlay, a taxpayer generates current expenses without necessarily realizing the associated income. This strategy accelerates deductions and has the result of deferring income taxes. This is precisely what Boccardo sought to do.

Such tax avoidance is not permitted. The well-established principle of matching income and expenses dictates that expenses, and income associated with those expenses, must be recognized in the same tax period. Treasury regulations apply this principle to both cash and accrual methods of accounting: “If an expenditure results in the creation of an asset having a useful life which extends substantially beyond the...

83. Treas. Reg. § 1.446-1(c)(1)(i) (as amended in 1995). (“[A]ll items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received,” and “[e]xpenditures are to be deducted for the taxable year in which actually made.”).

84. Income is reported “when all the events have occurred which fix the right to receive such income and the amount thereof can be determined with reasonable accuracy” and expenses are deducted when “all the events have occurred that establish the fact of the liability, [and] the amount of the liability can be determined with reasonable accuracy.” Treas. Reg. §§ 1.451-1(a) (as amended in 1993), 1.461-1(a)(2) (as amended in 1994).

85. Bittker, supra note 11, ¶ 105-45. Bittker discusses the concept of matching and provides a list of cases upholding the rule for cash method taxpayers. For a more general discussion, see Chirelstein, supra note 11, § 11.02.
close of the taxable year, such an expenditure may not be deductible... for the taxable year in which made.\textsuperscript{86}

Applying this principle to \textit{Boccardo II} illustrates the flaw in the Ninth Circuit’s holding. Mr. Boccardo, like most contingency attorneys, uses the cash method of accounting. By holding that his advances are “ordinary and necessary” expenses, the court allowed Boccardo to deduct all of the expenses in the year paid, rather than in the year the associated income was realized. \textit{Boccardo II} thus violates the matching principle and results in a windfall for contingency attorneys. Attorneys may deduct advances as they are made while deferring the associated income for as long as the case takes to settle.

Such an approach violates traditional accounting principles and therefore it is surprising that the court apparently did not consider any alternative analytical framework. Most obviously, the court could have acknowledged the limited economic differences between gross and net fee agreements, but still retained the traditional “akin to loan” analysis. Finding economic differences does not automatically jettison the traditional analysis, especially in a case such as this where one must strain to actually find those differences. The court could have reasonably concluded that, even if gross and net fee contracts are different, the differences are not great enough to merit undermining established case law.

IV. ADVANCES SHOULD BE TREATED AS INVESTMENTS

As discussed, both the traditional analysis and the ordinary and necessary approach are flawed. The traditional approach is based on a fiction—that advances are like loans. Terming advances ordinary and necessary expenses, while comporting more with the business reality of the contingency agreement, violates the tax accounting principle of matching income with expenses. Fortunately, there is a third approach which recognizes the business reality of contingency agreements in which the attorney advances litigation costs while complying with accounting principles. This approach treats the advances as investments made by attorneys in their clients’ claims. Under this approach, expenses are deducted in the same year in which gain (or loss) is recognized, that is, when the funds are collected.

\textsuperscript{86} Treas. Reg. § 1.461-1(a)(1) (as amended in 1994).
A. Attorneys Treat Advances as Investments

The "investment analysis" most closely represents what really occurs in a contingency fee arrangement. When a personal injury attorney interviews a potential client, the attorney evaluates the strengths and weaknesses of the client's claim. The attorney considers the evidence, witnesses, potential amount of the claim, and whether, if damages are awarded, the defendant has the resources to pay. In short, the attorney employs experience, training, and knowledge to decide whether or not to take the case.

This decision is similar to that of any investor considering a new investment. An investor typically seeks to use assets in the manner most likely to generate gain with the least risk possible. If an investment seems promising, the investor expends money, time, or other assets in expectation of a future return. The attorney, like the investor, controls certain limited resources. In the attorney's case, these include cash, an existing overhead, and most importantly, his or her own time and skill. The attorney evaluates how best to invest these resources by selecting which claims, of all the claims reviewed, possess the most likely chance of providing a good return on the investment of these resources.

Once the attorney selects a claim/investment, the attorney expends assets to pursue a return on that investment. Advances are one component of these expenses. Advances risk cash in the present in expectation of a high return when the case settles in the future. The attorney also expends a certain amount of overhead on each case and, of course, his or her own time.

This form of investment possesses unique characteristics. The actual "asset" is not the claim itself because, even with the evolution of legal ethics over the past decades, an attorney is still not permitted to have an interest in a client's claim. Rather, the attorney invests in the ongoing right to represent the client and pursue the claim. Like any investment, this one bears certain risks. Most notably, the attorney may lose the case in court, or the attorney's share of the plaintiffs' damages may be less than the expenses incurred. In addition, a client may terminate the attorney before reaching settlement.


88. This is actually only a limited risk to the attorney. The standard contingency fee agreement, although providing an absolute right to terminate an attorney, requires the client to pay "reasonable value" to the attorney for work on the claim. In Boccardo's practice, this occurred in less than one
An analogy to a different type of investor, an investor in mineral rights, is useful to understand the proper tax treatment of expenses advanced by a contingency attorney. Mineral rights investors carefully select what property is likely to possess potential for profitable extraction of minerals. After selecting a property, the investor advances royalty payments to the property owner in exchange for the right to mine. The advance is guaranteed. Even if the land fails to yield any income to the investor, the property owner retains the "advance." In short, just as a contingency fee attorney carefully screens cases and does not recover advances if he or she loses the case, so too the mineral investor carefully scrutinizes property and also will not recover advances. However, unlike in the lawyer's situation, the tax treatment of advances made by mineral investors is clear. They are deductible not when paid, but rather when the benefits (income) tied to the outlays are received. Of particular relevance for the traditional akin-to-loan approach is that no inquiry is made into the mineral investor's past track record as an indicator of future likelihood of success.

B. Advantages of Characterizing Advances as Investments

Characterizing advances as investments solves both the problems inherent in the traditional "akin to loan" approach and the problems in the Ninth Circuit's ordinary and necessary expense conclusion. As discussed, the major flaw of the traditional analysis is the fiction that advances resemble loans. The investment characterization eliminates the fiction by seeing advances for what they are: calculated business investments made in hopes of high financial return. The investment characterization also avoids the major drawback of considering advances ordinary and necessary expenses: the violation of the tax accounting principle of matching expenses with income in the same tax period. Like other investments, income (or loss) would be recognized upon disposition of the asset. Here the disposition is the resolution of the legal claim. Thus, the advances would be deducted at the same time as the income or loss is recognized.

percent of all claims. Boccardo v. Commissioner, 65 T.C.M. (CCH) 2739, 2740 (1993), rev'd, 56 F.3d 1016 (9th Cir. 1995).

89. This approach is based on the principle that, even for a cash method taxpayer, prepaid expenses may not be deductible. Rev. Rul. 77-489, 1977-2 C.B. 177; Rev. Rul. 80-70, 1980-1 I.R.B. 5; see also Bittker, supra note 1, §105.2.5.

Although this approach is superior to alternative approaches, the investment analysis presents its own unique challenges. The first challenge relates to the character of the gain or loss. If an advance represents an investment, and therefore the attorney is treated as an investor, then shouldn’t the proceeds to the attorney upon disposition of the investment be a capital gain or loss? I.R.C. section 83 of the tax code addresses this question. I.R.C. section 83 provides that where property (the right to pursue a claim) is transferred in connection with the performance of services (legal representation), then the property “shall be included in the gross income of the person who performed such services in the first taxable year in which [the person can dispose of the property].” In short, advances may be investments for timing purposes, but are prevented by existing code from achieving the character of a true capital asset. They retain their character as ordinary expenses, deferred until disposition of the asset. The second challenge, ethical constraints, is discussed below.

V. THE ETHICAL CHALLENGE TO THE INVESTMENT APPROACH

Legal ethics present the most fundamental challenge to the investment characterization for two reasons. However, as this Note will explain, neither of these reasons provide a meaningful impediment to treating advances as investments. Rather, they demonstrate the difficulty in general of deciding tax issues based on public policy and the particular challenge in the case of attorney advances.

The first potential problem is that converting the attorney from a service professional to a capital investor directly attacks long held notions of the attorney’s role. “Investing” in a client’s action remains contrary to legal rules of conduct. However, as law is practiced today, ethical injunctions against paying client expenses have become a house of cards. Traditional ethical compunctions based on common law concerns of maintenance and champerty are inapplicable in the modern practice of law. Furthermore, even if the bar is intent on retaining some

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91. The code considers property an asset unless covered by one of the listed exceptions. I.R.C. § 1221 (1996). Because the right to pursue a claim is not listed in the exceptions, it qualifies as an asset.


93. See supra note 87 and accompanying text.

94. See supra part II.
of the traditional prohibitions on the practices of contingency attorneys, the tax arena hardly seems the appropriate forum in which to do so.

The second impediment provided by legal ethics is based on the jumbled and confused state of ethical prohibitions against paying client expenses. Many jurisdictions explicitly permit attorneys to pay expenses incurred in representing their clients in contingency matters, as long as the expenses will be reimbursed to the attorney out of any settlement amount. Under this approach, a client has no responsibility to repay in the event that the settlement does not cover the cost of the expenses. Such an approach is consistent with Model Rule 1.8(e) of the American Bar Association. However, other jurisdictions retain the traditional rule holding clients ultimately liable for all expenses incurred on their behalf. Further confusing matters, federal courts have rejected prohibitions against paying client costs in certain types of cases. Finally, even in those states which retain the traditional rules, enforcement is inconsistent at best.

Thus, depending on the state, violations of ethical rules against investing in a client's claim or paying client expenses may subject an attorney to sanctions, including disbarment. However, the issue in Boccardo II was a tax question, not what is permissible within an attorney-client relationship. General ethical considerations, like broad public policy grounds in general, are disfavored as a basis for tax rulings. Rather, in challenging the actions of a taxpayer, the IRS must cite specific code provisions. In Boccardo II, the relevant code provision was section 162(c), which prohibits deductions for "illegal bribes, kickbacks, and other payments." I.R.C. section 162(c)(2) establishes a three-part test under which payments may be termed "illegal" and therefore not deductible. First, the payment must be illegal "under any law of the United States, or under any law of a State."

95. See Chofnas & Walker, supra note 47, at 85 & n.14 (discussing changes taking place in ethical prohibitions and listing states that have adopted Model Rule 1.8(e)).
98. See, e.g., Rand v. Monsanto Co., 926 F.2d 596, 600 (7th Cir. 1991). Rand involved a class action claim. The court ruled that in class action claims, individual claimants need not be held responsible for all costs incurred on their behalf, even if this contradicts state bar rules. Id. at 601.
99. Hazard, supra note 39, § 1.8:602.
100. Bittker, supra note 11, ¶ 20.3.3.
101. Id.
103. I.R.C. § 162(c)(2) (emphasis added).
Second, the illegal payment must subject “the payor to a criminal penalty or the loss of license or privilege to engage in a trade or business.” The IRS must show that the advances are illegal under a federal or state law. This raises the question of whether a state bar’s professional rules of conduct qualify as law. Bar rules are typically adopted by state supreme courts and thus, probably could be considered state common law. In states where the rules of conduct do not have force of law, payments of client expenses by attorneys simply are not “illegal.” Thus, under section 162(c)(2), there is no basis to deny deductibility of these payments.

Assuming, for the sake of argument, the payments are “illegal,” the attorney presumably risks disbarment. Although this would satisfy the second prong of section 162(c)(2) providing that an illegal payment must subject the payor to “the loss of license or privilege to engage in a trade or business,” the final requirement of section 162(c)(2), showing that the state law is “generally enforced,” presents a much more difficult challenge. In most state bars, there is little desire to force an attorney to collect payments from a client. Given the flux and uncertainty in ethical codes governing advances, bar associations are understandably reluctant to enforce prohibitions against paying client expenses. On a more practical level, as noted earlier, such enforcement places the bar in the awkward position of forcing attorneys to demand payment from clients who have just lost personal injury lawsuits. The specter of an attorney suing his own client, a client perhaps still suffering the effects of the injury which gave rise to the lawsuit in the first place, presumably gives the bar pause. Misgivings about enforcement increase when one considers that the attorney who is suing for collection is the very same

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104. I.R.C. § 162(c)(2).
105. I.R.C. § 162(c)(2).
106. I.R.C. § 162(c)(2).
107. Boccardo II pointedly avoided a direct ruling on whether state bar rules adopted by the California Supreme Court should be considered “state law,” saying only that they “might, in a pinch, be treated as state law.” This was because California had a state statute which regulates the same matters. Boccardo v. Commissioner (Boccardo II), 56 F.3d 1016, 1019 (9th Cir. 1995).
108. I.R.C. § 162(c).
109. In Boccardo II, the court found no “evidence of such enforcement” and cited sources indicating a lack of enforcement. 56 F.3d at 1020.
attorney who "lost the case," or at least failed to achieve a settlement adequate to cover expenses, not to mention any recovery for the client.

In short, the IRS will rarely, if ever, achieve its burden of showing that an attorney who pays client expenses violates a generally enforced law which subjects that attorney to criminal penalty or the loss of license. Failing this burden, the IRS is not permitted, as it once was, to cite general criteria such as "public policy" to deny a deduction. The court in Boccardo II stated this principle: "The line of ethical inquiry pursued by the Tax Court ends when it becomes apparent that the criteria set by section 162(c) for disqualifying a deduction have not been met."110 Attorneys who pay client expenses generally do not violate section 162(c). Therefore, under tax law, ethical constraints and rules of practice do not prohibit deductions for these expenses, whether treated as investments or as ordinary and necessary expenses.

VI. CONCLUSION

In Boccardo II, the Ninth Circuit recognized the problems inherent in the traditional tax treatment of advances made by lawyers working on contingency. Advances are neither "akin to loans" nor are they "illegal" as law is currently practiced. Having properly rejected traditional tax treatment, the court held that advances are ordinary and necessary expenses. Unfortunately, this approach violates the tax accounting principle of reporting expenses and associated income in the same tax period. The court should have treated advances as what they really are: investments risked by attorneys in expectation of future financial returns. The investment analysis avoids the "akin to loan" fiction employed by case law while adhering to the principle of matching income with expenses. Although treating the attorney as an investor may challenge traditional notions of legal ethics, the tax treatment of advances is based on the IRS code, not state rules of conduct. Until state bar associations choose to enforce rules against advances and thereby make them "illegal" for tax deductibility purposes, advances should be treated as what they are: investments.

110. Id.