

## Tax Attorneys – Does 26 USC 6050P allow me to receive tax credits for unpaid bills (“charge-off” debts) from legal clients?

---

Friends -

Apologize in advance for being a little long winded.

I have had situations with clients where the case ends and they owe me money. I sent one such debt to a debt collector, and when that so-called collector failed to collect, I took that client to an attorneys fee arbitration panel operated by my state bar. After the lunatic started shouting down the arbitrators about the attorney fees he believed he was owed (he's not a lawyer), the panel determined the next day he owed me the money. But that was a real hassle, I can't get attorney fees for the time I spent preparing for that arbitration, and I am lucky he didn't understand that that he could not file a bar complaint through the fee arbitration section of the bar.

Other businesses always seem to be able to charge off unpaid debts - can't I just do the same? I seem to recall my accountant telling me that a lawyer could not do the same. Is that correct, or did I simply misunderstand him? Perhaps he was just referring to contingency fees (opportunity costs)?

I got a client a \$30,000 settlement in 2013, but the defendant sent the check directly to her and I thus, I never saw any part of my \$9000 (contingency fee of 30%), which would go a long way toward helping me settle my 2013 taxes.

I seem to recall my accountant telling me that a lawyer could not do the same. Is that correct, or did I simply misunderstand him? Perhaps he was just referring to contingency fees (opportunity costs)?

Can't 26 U.S.C. 6050P enable me to "charge off" debts from clients?  
<http://www.law.cornell.edu/uscode/text/26/6050P>

According to subsection (c)(2)(D) of the statute, an applicable financial entity can include "any organization a significant trade or business of which is the lending of money." Part of my agreements indicate that interest will be charged for outstanding debt after a certain amount of time passes. Isn't lending money all about charging a fee for use of capital?

---

No you can't do this. You never booked the income, so you have nothing to charge off. If, on the other hand, you give a refund to a client, you can deduct that amount from your income.

Nanci Bockelie, Utah

---

I am not a tax lawyer, but generally the issue is that most attorneys operate on a cash basis. If you operated on an accrual basis you would recognize income when billed, not when received. On a cash basis, you recognize income when received, not when billed. Therefore an accrual-basis taxpayer may recognize a deduction for debts unpaid (because income was recognized already) but a cash-basis taxpayer does not write off bad debts because they were never recognized as income.

Darrell G. Stewart, Texas

---

Nanci, yes, I finally found out \*finally\* trying to do my own taxes on Turbotax that I can deduct for refunds to clients. My accountant, the so-called "\*law firm specialist\*," never asked me whether I gave any clients a refund.

So, for the first time ever, I will be deducting the refunds I gave clients in 2013.

But what I am talking about here is the \$9000 owed to me on the \$30,000 the client received, via my contingency fee agreement with that client.

You're saying there is \*no way\* for me to get my 30% out of the client other than taking her to arbitration? Apologize if I am being repetitive or asking you all to repeat yourselves out there. Thanks a million.

Gerald Gilliard, Washington, D.C.

---

I read about cash v. accrual for the first time on Sunday.

I assume that my accountant did my taxes on a cash basis, but I will also ask him. Now when I file my own taxes, or get some different accountant to file them, hopefully I can file them on an accrual basis.

Gerald Gilliard

---

The fee your client owes you isn't a debt in the same way it would be if you handed over \$9,000 cash. You aren't actually out any money (I know it hurts to think that!) because you never had it. Yes, you can sue your client, but no you don't get any tax break, because you are talking about money you never had, never paid tax on, etc.

Nanci Bockelie

---

STOP!

Be sure you understand the ramifications of accrual basis accounting. You will pay tax on all of the income when you earn it regardless of whether or if you receive payment. That will normally increase your tax burden.

Yes, you would have bad debt deductions but I doubt that you want to pay the price to get them.

YMMV!

Jim Pardue, North Carolina

---

Assuming my accountant used cash basis to file my taxes for the past decade, what will be the ramification of switching horses midstream and going with accrual basis for the first time?

Gerald Gilliard

---

First of all, deciding to change from cash to accrual is an change in accounting method, and requires IRS approval. It's not just as simple as saying "oh, I think I'll be accrual now." If it was, people would flip-flop between methods, using whichever was most beneficial that year. (having said that, if you go over \$5 million in gross revenues, accrual accounting is required for most businesses, but not lawyers. There is a proposed change to make it \$10 million for everyone, but that's proposed, not current).

Second, accrual accounting, as Jim said, requires you to recognize income when earned. So you did 50 hours of work on that PI case this year that won't settle before next year at best? Too bad - you're picking up the 50 hours, even if you won't actually see the money.

Third, I've written a lot about using a 1099-C to "write off" debts - in short, it's not the panacea that people think it is. The IRS does not take

## SoloSez Popular Threads, September 2014

the position that a 1099-C is automatically income, so you don't necessarily hit the client in the pocketbook.

If the check wasn't made out to you and the client, your only solution is to sue. Good luck.

Greg Zbylut, California

---

I agree. Sometimes the "fix" for one issue causes more trouble. Taxes are certainly an area where this is common. Let me put it this way. There is a reason that most all attorneys who can use a cash basis for tax purposes.

Darrell G. Stewart

---

Gerald, the switch from cash to accrual is a change of accounting method for which a Form 3115 would need to be filed with the Internal Revenue Service. The purpose of the Form 3115 is to calculate a Sec. 481 adjustment which is the cumulative effect that making the change has on your taxable income in the current year. Could result in significant additional taxable income in the year that you make the change.

by

Brian Yacker

---

The biggest ramification will be that, in the first year you begin accounting in this manner, you must report all invoices you have issued that are not paid as accrued income, unless you have already written them off on your books. And pay taxes on them.

Going forward, you will pay taxes on every invoice that goes out. As a solo, that means you'll be paying estimated taxes on money you may never earn, and the burden will be on you to track and report any discounts, adjustments, or write-offs that change the bottom line of an invoice when it is paid, or when you decide/discover that it will not be paid, as all of those must be reported as adjustments to gross income.

If you should sue for a fee and get a judgment, that income will remain taxed and on your books until you recover on the judgment - assuming you ever do - and when you do recover on it, you must report the interest as income (as you normally would, of course), and you must track when the judgment expires (if you allow it to), as only then can you write it off as unrecoverable.

I'm not a CPA, but that's my understanding of it.

In short, it will generally require a good deal more bookkeeping on the part of you and your accountant, and some of it will potentially require looking back as far as the life of a judgment in your jurisdiction

## SoloSez Popular Threads, September 2014

each year. Just because it allows you to "write off" unpaid bills or discounts, it WILL \*NOT\* reduce your tax bill, and may very well increase it.

-Rick

Richard J. Rutledge, Jr., North Carolina

---

You may pay taxes on income you haven't received (yet).

Pat

Patricia Kane Williams, New Jersey

---

NO!!

You are not an accrual based taxpayer. You are a cash based taxpayer. Are you even an entity? Do you want to take into income money before you ever see it?

The sad answer is that you can't take a deduction for money billed but never received

David A. Shulman, Florida

---

I have never seen a taxpayer voluntarily switch from cash to accrual tax reporting. Most taxpayers who have an option prefer the cash basis reporting so that they can control income, to some extent.

Most taxpayers would see an increase in income (and tax liability) when they make the switch. Even after the switch, your situation with the uncollected fee would be a wash, at best. You would include the \$9,000 fee in income and then deduct the bad debt. The ultimate irony would be if the IRS disputes the bad debt deduction and disallows the deduction.

Just for fun, I just glanced at the Form 3115 instructions. The last page estimates the recordkeeping/learning/preparing the form time at around eighty hours. I would want to find a CPA who has done this change of accounting method several times before engaging them to do this. I just inquired of my favorite CPA/tax lawyer and he has never seen one either.

No, I am not looking for work in that area.

Good luck!

Jim Pardue

---

## SoloSez Popular Threads, September 2014

---

Thanks everyone. I'll do more of my own independent research, but I don't think I'll make the switch.

---

No matter what you do, you aren't going to be able to deduct the uncollectable. If you were an accrual based taxpayer, you would have had to have taken it into income first, and then you could deduct if it were bad. As a cash based taxpayer, you never took it into income.

Accrual: 100 income - 100 deduction = 0

Cash: 0 income - 0 deduction = 0.

You aren't getting anything by switching. I've never heard of an accrual method law firm.

What type of entity are you running your practice as?

David A. Shulman

---

Single member LLC.

---

Disregarded, I assume. You didn't check the box and/or elect S? In that case, you're just an individual and really can't be on the accrual method (not that you could anyway).

David A. Shulman

---

The answer here is to get a better accountant who understands your business. You as an individual are a cash basis taxpayer, not accrual.

Stephanie J. Hill

---