



# Staff Memorandum

## **EXECUTIVE COMMITTEE Agenda Item #23**

**REQUESTED ACTION:** Approval of the report and recommendations of the Committee on Law Practice Management with respect to proposed federal legislation to require law firms to use the accrual method of accounting.

Attached is a memorandum from the Committee on Law Practice Management outlining proposed legislation that would require law firms and other professional service firms with annual gross receipts in excess of \$10,000,000 to use the accrual method of accounting rather than the cash method of accounting. Under the accrual method, law firms would be required to pay tax on prospective income for services rendered before payment is received. The committee notes the adverse effect this requirement would have on lawyers and therefore recommends the adoption of a resolution opposing the proposal.

On April 8, 2014, Association leaders will participate in ABA Day in Washington. If this report is approved, those participating in ABA Day will discuss this legislation with members of Congress and urge opposition.

The report will be presented by Mark S. Gorgos in his capacity as the committee's Executive Committee liaison.



## MEMORANDUM

**To:** Members of Committee on Law Practice Management (NYSBA)

**From:** Special Subcommittee on Proposed Tax Legislation (A. Fletcher, J. McCarron, R. Ostertag & P. Zandri)

**Cc:** Kathy Suchocki, Director, NYSBA Law Practice Management

**Date:** March 17, 2014

**Re:** Request for LPM Committee Approval of Resolution Against Proposed Federal Tax Legislation Affecting Law Firms & Other Professional Service Firms

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### Summary of Proposed Tax Legislation

If enacted, proposed federal tax legislation would require law firms and other licensed professional service firms with annual gross receipts in excess of Ten Million Dollars (\$10,000,000) to use the accrual method of accounting.<sup>1</sup> Accordingly, these firms would be precluded altogether from electing the cash basis method of accounting when recognizing income. If such proposed legislation were enacted, law firms, accounting firms, and other licensed professional service firms would as a consequence be required to pay tax on prospective income for services rendered prior to their receipt of payment.

### Findings of Subcommittee

A Special Subcommittee of LPM was convened to review the proposed legislation which unanimously agreed that the enactment thereof would have an adverse material effect on the legal

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<sup>1</sup> More specifically, the House's proposed legislation is Section 3301 of the draft "Tax Reform Act of 2014" and Section 51 of the Senate's companion bill. See Exhibit A.

profession. Consequently, the Special Subcommittee is proposing that LPM adopt a resolution, similar to that of the ABA's previously-adopted resolution,<sup>2</sup> objecting to Congress' enactment of such legislation. The Subcommittee's findings and the bases for its objections included, *inter alia*:

1. The default rate of clients in relation to invoices presented for services rendered;
2. The adverse residual effect upon pass-thru entities;
3. The perverse effect upon law firm partners who either resign, retire, seek lateral employment or are terminated;
4. The disparate impact thereof upon contingency versus non-contingency practitioners in the overall market for legal services;
5. The complexity of determining when income must be recognized, whether upon production of a retainer, periodically, upon completion of the engagement or otherwise;
6. The disincentive to organizing large law firms and diminishing the otherwise corresponding benefits generally associated with economies of scale; and
7. The prospect of law firms passing the costs of compliance on to their clients. through charging higher fees for services.

#### Proposed Resolution

On the basis of the foregoing, the Special Subcommittee submits for adoption by the Committee on

Law Practice Management the following proposed resolution:

WHEREAS, proposed federal tax legislation would require law firms and other licensed professional service firms with annual gross receipts in excess of Ten Million Dollars (\$10,000,000) to use the accrual method of accounting;

WHEREAS, upon review and deliberation of same, a Special Subcommittee of the NYSBA Law Practice Management Committee has concluded that the enactment of such proposed federal tax legislation would have an adverse material effect upon law firms and their present and prospective clients;

NOW, THEREFORE, LET IT BE RESOLVED, that the Committee on Law Practice Management of the New York State Bar Association objects to and opposes any proposed legislation or regulatory promulgation that would require law firms and other licensed professional service firms to be limited exclusively to the accrual method of accounting.

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<sup>2</sup> See Exhibit B.



## ABA Legislative Action Alert

# Urge Congress to Reject Burdensome Tax Proposal that Adversely Affects Many Lawyers and Law Firms

We need your help to convince leaders of the House Ways & Means and Senate Finance Committees to remove key provisions from their draft tax reform bills that would impose substantial new financial burdens on many law firms, accounting firms and other personal service businesses throughout the country. These harmful provisions would require all such firms with annual gross receipts over \$10 million to use the accrual method of accounting rather than the traditional cash receipts and disbursement method. As a result, all of these firms would be forced to pay taxes on income they have not yet received and may never receive.

### BACKGROUND

Current law allows individuals and most partnerships and other pass-through entities—as well as other types of businesses with annual gross receipts of \$5 million or less—to use the simple cash method of accounting for tax purposes, in which income is not recognized until cash or other payment is actually received. In addition, all law firms, accounting firms, and various other types of personal service businesses are allowed to use the cash method of accounting regardless of their annual revenue unless they have inventory. Most other businesses are required to use the more complicated accrual method of accounting, in which income is recognized when the right to receive the income arises, not when the income is actually received.

Last year, House Ways & Means Committee Chairman Dave Camp (R-MI) and Senate Finance Committee Chairman Max Baucus (D-MT) released separate discussion draft tax reform bills containing provisions that would fundamentally change the manner in which many law firms and other personal service businesses must pay their taxes. Section 212 of Chairman Camp's draft ["Tax Reform Act of 2013"](#) and Section 51 of the [similar draft bill](#) by Chairman Baucus would dramatically change current law by raising the gross receipts cap to \$10 million while eliminating the existing exemption for law firms and other personal service businesses, partnerships and S corporations, and farmers. The practical effect would be to substantially accelerate the firms' tax payments.

In November 2013, the ABA Board of Governors adopted a [Resolution](#) opposing the draft legislation and any other similar measures that would require law firms and other personal service businesses to switch from the cash to the accrual method of accounting. Similar resolutions have been adopted by a number of state bars, including those in Ohio, Minnesota, New Jersey, and Wisconsin, and other bars are now considering taking similar action.

On January 13, 2014, the ABA sent [letters](#) to the House Ways & Means and Senate Finance Committees opposing Sections 212 and 51 in the respective draft bills. The ABA expressed concerns that these provisions would create unnecessary complexity in the tax law; increase compliance costs; and cause substantial hardship to many law firms and other personal service businesses by requiring them to pay tax on income they have not yet received and may never receive. Therefore, the ABA urged the Committees to remove these provisions from the draft bills. The ABA's concerns are more fully explained in the [ABA Fact Sheet](#) on this issue.

### URGENT ACTION REQUESTED

**The ABA needs your bar's help** to persuade leaders of the House Ways & Means and Senate Finance Committees to remove Sections 212 and 51 from the House and Senate draft bills, respectively. Please assist us in this effort by:

- **Adopting a resolution** opposing these provisions in the draft legislation (See [model bar resolution](#)); and
- **Emailing or faxing letters to your Members of Congress** urging them to oppose the legislation and to convey their views to the relevant Committee leaders. (See [sample bar letter to Representatives](#) and [sample bar letter to Senators](#).) Because the [House Ways & Means Committee](#) or [Senate Finance Committee](#) could schedule a mark-up and vote on the draft bills at any time, all state and local bars with Members on either Committee are especially encouraged to send letters to those Committee Members as soon as possible.

If you have any questions or if you adopt a resolution or send letters to Congress, please contact Larson Frisby, Associate Director of the ABA Governmental Affairs Office, at (202) 662-1098 or [larson.frisby@americanbar.org](mailto:larson.frisby@americanbar.org). This will help us to coordinate and follow-up on your efforts. Thank you for your assistance on this important issue.

**MODEL STATE/LOCAL BAR RESOLUTION**  
**OPPOSING LEGISLATION REQUIRING LAW FIRMS TO USE ACCRUAL ACCOUNTING**  
**AND PAY TAXES ON INCOME NOT YET RECEIVED**

**(updated 1/30/14)**

**RESOLUTION ADOPTED BY THE [NAME OF BAR ASSOCIATION]**

\_\_\_\_\_, 2014

RESOLVED, that the [name of bar association] opposes any proposed legislation, regulations, or other governmental measures that would require law firms and other personal service businesses that now compute taxable income on the cash receipts and disbursements method of accounting to convert to the accrual method of accounting, thereby accelerating their tax payments.