LAW FIRM MANAGEMENT

FALL 2022

4 year-end tax tips for law firms

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Do you have the right retirement plan?

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4 year-end tax tips for law firms

The end of the tax year for calendar-year law firms is just around the corner. Now's the time to take those last-minute steps that can reap significant savings on your 2022 return. Here is some tax-cutting advice to consider.

1. TIME INCOME AND EXPENSES WISELY.

Deferring revenue into the next tax year and accelerating expenses (including state and local income tax estimated payments due in January) into the current tax year is a tried-and-true strategy for businesses that use cash-basis accounting. Your firm could, for example, delay billing until late December and expedite the payment of bonuses.

There's a big caveat, though. If your firm expects to earn greater revenue in 2023, you may well be better off reversing the strategy — accelerating revenue and deferring expenses. You'll reduce your 2023 taxable income and boost the value of the expense deductions.

2. TAKE ADVANTAGE OF 100% BONUS DEPRECIATION.

The Tax Cuts and Jobs Act (TCJA) increased the bonus depreciation deduction to 100%. The increase is temporary, though, and 2022 is the last year the full 100% deduction is available. Beginning in 2023, the deduction will drop by 20% each year, until sunsetting in 2027, absent congressional action.

To make the most of bonus depreciation, your firm can purchase computer systems, software, equipment and office furniture, among other depreciable items. The deduction also applies to qualified improvement property (generally, interior improvements to nonresidential property). Order now to ensure you can place the items in service before year-end. If you determine that the deduction will be worth more in the future due to higher revenue you can simply refrain from placing them in service for now.

Your firm also might benefit from the Section 179 expensing provision, which allows smaller businesses to immediately deduct 100% of the purchase price of new and used qualifying property. The maximum Sec. 179 deduction for 2022 is $1.08 million. It begins phasing out on a dollar-for-dollar basis on qualifying property purchases above $2.7 million.

3. RECONSIDER YOUR RETIREMENT PLAN.

Law firms that don't already offer a retirement plan may qualify for a tax credit of up to $5,000,

WAYS FOR ATTORNEYS TO REDUCE PERSONAL TAX LIABILITY

Individual taxpayers have some avenues to reduce their taxes, too. For example, the stock market's rocky year may mean taxpayers should consider loss harvesting and Roth IRA conversions.

Taxpayers that have realized gains during the year may want to sell poorly performing investments, thereby reducing the gains on a dollar-for-dollar basis. Generally, individuals can apply excess losses against up to $3,000 of ordinary income, with the remaining balance carried forward to future tax years. By donating the sale proceeds to charity, individuals can claim a charitable contribution deduction if they itemize as well.

This also is an opportune time to convert part or all of a pre-tax traditional IRA to an after-tax Roth IRA. Roths have no required minimum distributions, which allows longer tax-free growth. Taxpayers will have to pay income tax on the fair market value of converted assets — but individuals who convert stocks that have fallen in value or are in a lower tax bracket this year won't take as much of a tax hit.

for three years, for the ordinary and necessary costs of starting a plan. The credit generally is available only to small businesses with 100 or fewer employees. Your firm can start claiming the credit in the tax year before the tax year that the plan becomes effective. Including an automatic enrollment feature can add a tax credit of $500 per year for a three-year taxable period beginning with the first taxable year of the feature.

Firms that already have a plan can fund certain plans until the tax filing date and claim the deduction. Now is the time to re-evaluate your current plan to ensure you're offering the most tax-advantageous type (see "Benefits for small and mid-sized firms: Do you have the right retirement plan?" on page 7).

4. ENJOY SOME FULLY DEDUCTIBLE MEALS WHILE YOU CAN.

The 2021 Consolidated Appropriations Act increased the allowable deduction for business meals from 50% to 100% in 2021 and 2022 — as long as the expense is for food or beverages provided by a restaurant. Food and beverage expenses must not be lavish or extravagant, and the taxpayer or an employee must be present.

In addition, certain meal-related expenses are always 100% deductible. That includes expenses related to recreational, social or similar activities for employees, such as holiday parties (as long as they don't favor highly compensated employees). Note that free food and beverages in break rooms or provided for the convenience of the employer, such as meals made available for employees who must stay on call for emergencies, are subject to the applicable business meal limit.

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ACT NOW

Some of the tax breaks outlined above will be less valuable after 2022. For others, law firms need to do some forecasting of future revenues to determine the best move. We can help your firm plot the best course now. •

Buck the odds

SUCCESSFULLY HIRING AND RETAINING LATERAL ATTORNEYS

When law firms consider lateral hiring, most see it as a way to add niche expertise, management experience and bring in new clients. However, according to a recent survey by Decipher Investigative Intelligence and ALM Intelligence, nearly half of respondents indicated that the majority of their firm's laterals underperform when it comes to bringing their stated book of business. So firms need to carefully consider the need for lateral hires as the costs of bringing them on can be high.

MAKING THE DECISION

As attorneys retire or leave your firm, look closely for any gaps. Do you really need to hire a new lawyer or can you redistribute the work?

> *A healthy work environment promotes teamwork, open communication, professional development opportunities and recognition.*

If instead you're hiring to expand your offerings, be sure to articulate and quantify your expectations. Do you want the attorney to bring a book of business and contribute to increase firm revenues within a set time of his or her hire? If so, be sure that your expectations are realistic and that you provide the resources the lateral hire will need to meet these objectives (such as administrative staff and a marketing budget).

Don't forget to consider what you can offer a lateral hire. Compensation is important, but candidates also want to know how working for your firm will contribute to their professional development and affect their personal lives. Will you be able to deliver on any promises — such as a committee chair or flexible work hours — that you make at the recruiting stage?

MENTORING LATERAL HIRES

Failure to quickly assimilate lateral hires into the business and culture of your firm can easily lead to premature departures and lost clients. In fact, the integration period is when most firms win or lose their lateral hires.

Assign a mentor or sponsor — such as a practice group leader or senior partner — to guide your lateral hire through the first year at your firm. Experienced partners can help new hires get to know colleagues, particularly those with similar interests, and meet existing clients and learn about their needs. Working together with human resources, mentors can help laterals publicize their move and market their services, learn the firm's processes and technology solutions and resolve conflicts or problems.

For lateral hires who bring clients with them, sponsors need to do everything they can to ensure these clients become clients of the firm. Although the vetting process likely started at the recruiting stage, sponsors should help new hires review their client book for any conflicts of interest or liability issues — as well as cross-marketing opportunities.

The job of sponsor can be demanding. Consider incentivizing your sponsors so that they'll feel responsible for the lateral hires' smooth integration and professional well-being.

FITTING IN WITH FIRM CULTURE

The best advice for retaining lateral hires applies to all of your attorneys: Create a healthy

work environment. This starts by promoting teamwork, open communication, professional development opportunities and recognition — financial and otherwise.

Cultural fit is one of the most important decisions a hiring firm can make. In a Thomson Reuters analysis of lateral candidates, cultural fit was a top issue, with 68% of red flag candidates surfacing some behavioral concern.

Lateral hires that fail to fit in culturally may sour the relationship despite the candidate's legal skills and business acumen. According to the Decipher/ALM survey, 29% of respondents said lateral partners left because of cultural fit issues with other partners.

You can increase loyalty to your firm by helping lawyers balance their work with personal interests and obligations. Offer flexible and part-time hours — even for partners — and the ability to telecommute, plus benefits such as child care.

SETTING EXPECTATIONS

Law firms looking to expand will need to use lateral hires. Doing so successfully requires realistic expectations and smooth assimilation. Using some of the best practices presented here can help your firm succeed. •

Time to give origination credits a makeover

Competition among law firms — for new clients and new attorneys — remains fierce. Origination credits have long been a way of incentivizing business development as well as providing the kind of compensation that works as a strong recruiting tool.

But the historical methods for distributing origination credits are no longer compatible with the cultures and priorities of many firms these days. Moreover, they can create problems that undermine their intent. If any of these problems plague your firm, you may want to retool your policy for origination credits.

THE ORIGINATION CREDIT CONUNDRUM

Law firms have long given an origination credit to the partner who brings in a new client. That attorney continues to receive credit for all work flowing from that client, even if he or she isn't involved in it. Such an approach is replete with problems. Most obviously, it discourages collaboration.

It also can lead to frustrated younger attorneys. If some senior attorneys share their credit but others don't, the associates assigned to the latter earn less. (Plus, associates might clamor to work with the former, leaving the clients of nonsharers underserved.) The traditional approach doesn't nurture business development in associates early on and may push them to leap to competitors who award associates for such efforts.

In addition, it doesn't serve clients well. The originating partner may hoard work that a colleague is better qualified to perform. Partners might not assemble the strongest pitch team for a certain opportunity because they don't want to share the credit. This concern could also affect who's selected to work on a client team.

It's typically best to award credit to attorneys who bring value to a client's relationship with the firm, regardless of whether they brought the client on board.

Finally, the traditional approach undermines succession planning. A partner approaching retirement may want to hold onto a credit as long as possible. This can result in inadequate time to successfully transition clients to younger attorneys.

A BETTER APPROACH

Fortunately, no firm is stuck with its current origination credit system — you can refine your system to be more equitable and prioritize teamwork. When doing so, firms should keep several overriding considerations front of mind. For example, basing the credit amount on fees collected is the simplest and most straightforward formula.

It's typically best to award credit to attorneys who bring value to a client's relationship with the firm, regardless of whether they brought the client on board. That means making other partners, associates and possibly even paralegals eligible for credit sharing. For example, your firm might opt to award a share to partners who develop new business with an existing client.

You should develop a specific policy for credit-sharing, with clear metrics for what will be measured and compensated. The policy also should address how a credit will be distributed when the originating attorney departs.

It's wise to allocate origination credits by matter, not client. Such allocation also encourages other attorneys to expand the client relationship, growing revenues for the firm.

You also should provide a mechanism to incentivize senior attorneys to transition relationships in a timely manner before retirement. For example, you might double the credit in the years before retirement so both the senior lawyer and the lawyer taking over get credit.

ONE SIZE DOESN'T FIT ALL

There's no universal origination credit policy that will work equally well for all law firms. Take the time to develop a policy that reflects your firm's specific culture, goals and values. •

Do you have the right retirement plan?

Most law firms, regardless of size, offer some type of retirement plan these days. The plans provide critical tax, recruitment and retention and succession planning advantages. With numerous choices, it's worth taking the time to review the options.

SEP IRAs

Simplified employee pension (SEP) IRAs are probably the easiest and most flexible retirement plans. They provide a good option for solo practitioners or small firms with minimal staff.

Employers contribute a percentage of the employee's salary, but contributions aren't required every year. For 2022, employers can contribute up to 25% of an employee's compensation, with a maximum of $61,000.

INDIVIDUAL 401(k) PLANS

Individual 401(k) plans also are relatively simple. However, they're limited to self-employed individuals and business owners — including sole proprietors, C and S corporations, and partnerships — with *no* employees other than a spouse.

Accounts are funded with a combination of pretax salary deferrals and annual profit-sharing contributions. That's because employers can contribute as both the employer (profit-sharing contributions up to 25% of compensation) and an employee (up to $20,500 in salary deferral for 2022). The maximum combined contribution for 2022 generally is $61,000 ($67,500 with catch-up provisions). Annual funding isn't required.

SMALL GROUP 401(k) PLANS

These plans provide the retirement benefits and tax advantages of a traditional 401(k) plan to employers with more than 20 employees. Both employees and employers can contribute, but employer contributions can be discretionary. For 2022, an employee can contribute up to 100% of compensation, to a maximum of $20,500 (excluding catch-up contributions). Combined contributions for 2022 can total the lesser of $61,000 or 100% of compensation.

Employers can add vesting and participation rules. These plans do, however, come with a greater administrative burden.

CASH BALANCE PLANS

In contrast to the three plans above, which are defined contribution plans, a cash balance plan is a defined benefit plan. Cash balance plans are gaining popularity as a supplement to other plans for high-income individuals.

Law firms generally provide an additional deductible contribution to their partners, with a smaller contribution for staff. The plans are more complicated to administer and have annual funding requirements. However, they have significantly higher annual contribution limits than a traditional 401(k) plan (contributions are calculated by an actuary based on the benefit you set and other factors).

STAY ON TOP OF IT

Don't overlook the importance of your retirement plan. In today's tough recruiting environment, law firms should regularly evaluate their offerings. We can help you determine which plan is right for your firm. •

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