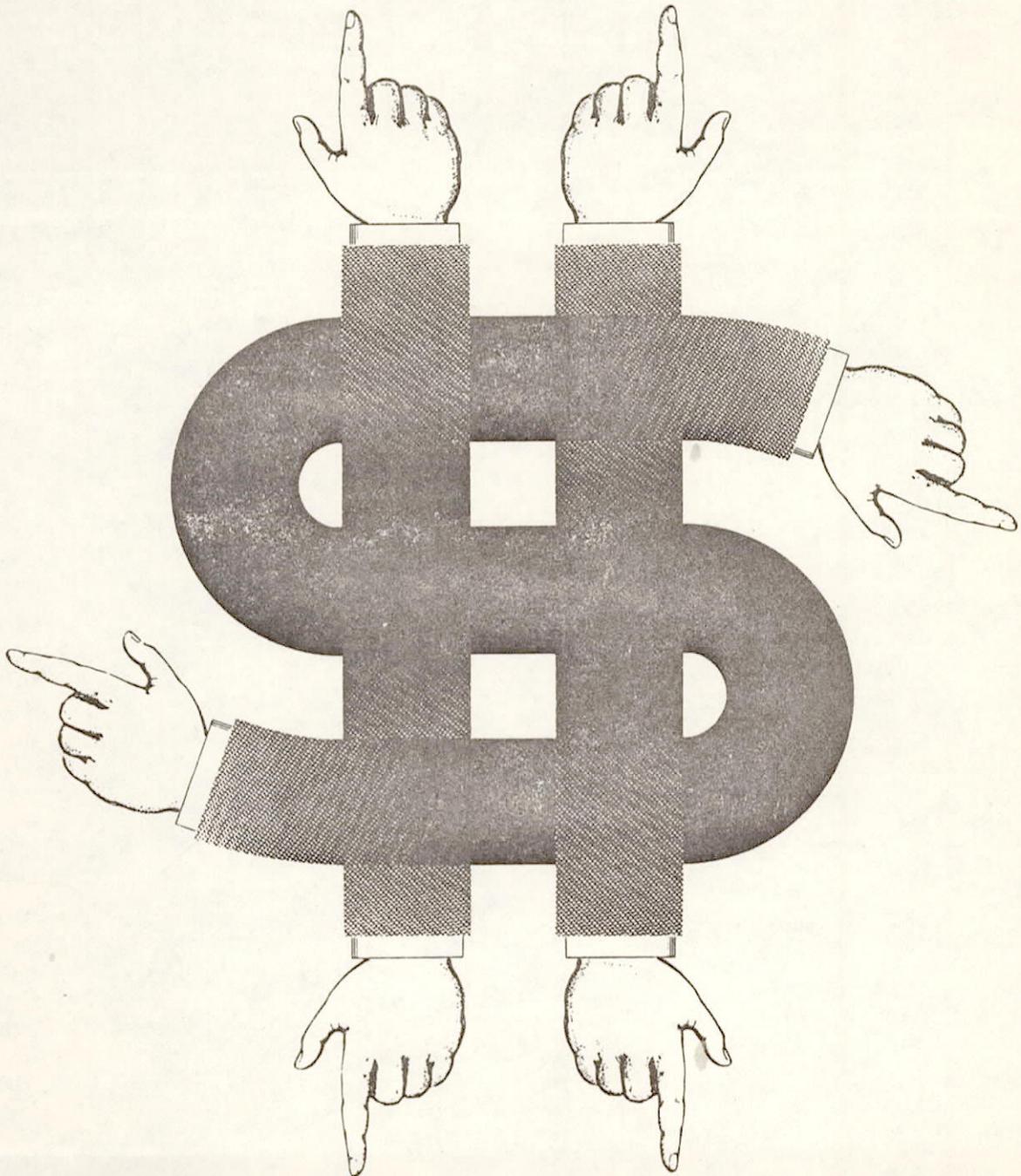
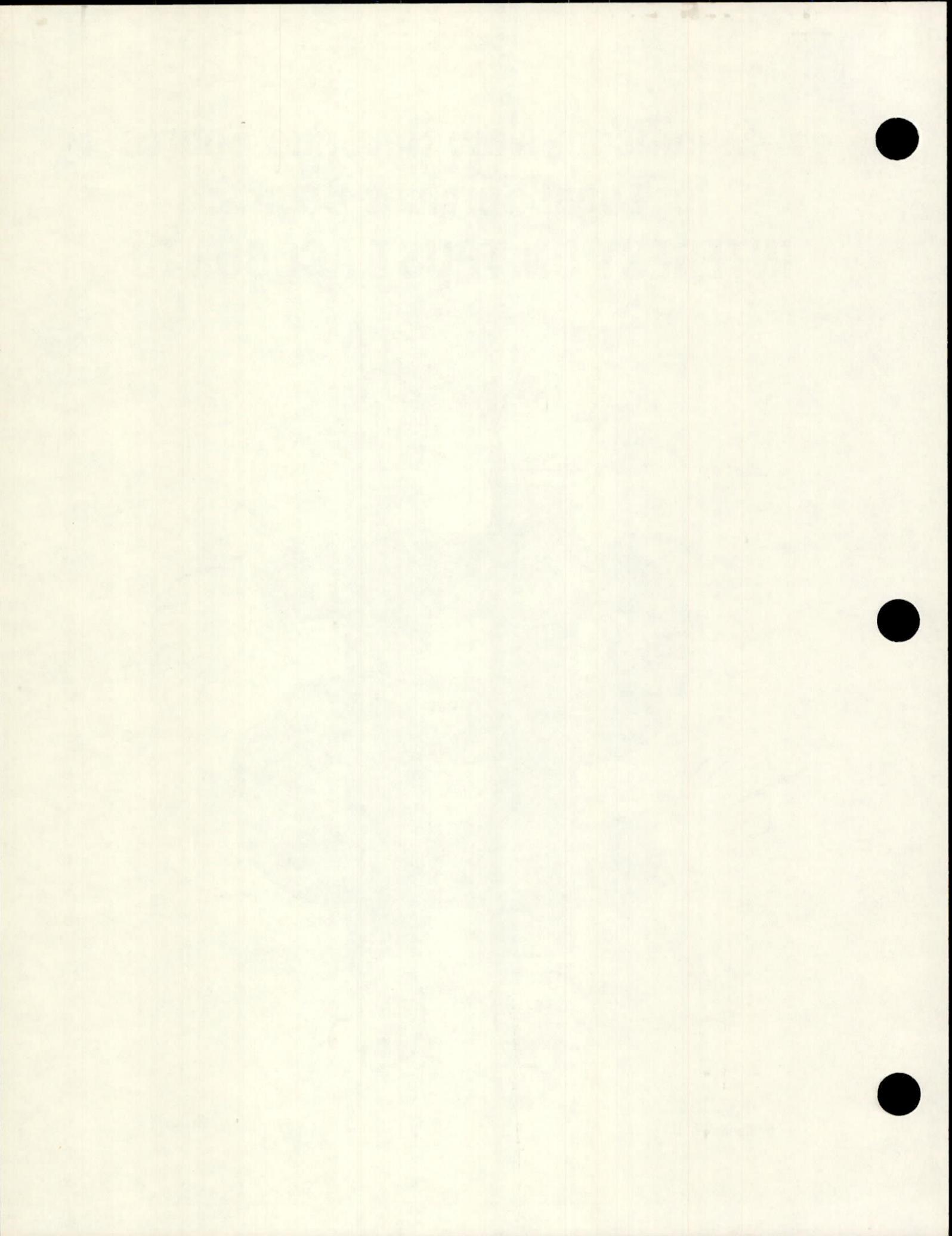


A Significant New Revenue Source for Legal Services Begins: INTEREST ON TRUST ACCOUNTS



by Randall C. Berg, Jr.



On September 1, 1981, Florida began operation of a significant new revenue source for legal services to the poor—the Interest on Trust Account Program.¹ On September 25, California's Governor signed that state's Interest on Trust Account Program legislation.² Other states are seriously contemplating similar programs.³

This article will introduce the Interest on Trust Account Program, review the Florida and California experiences, and provide recommendations to other states desirous of establishing such a Program.

The Interest on Trust Account Program

The concept underlying the Interest on Trust Account Program is quite simple. Attorneys routinely receive funds in trust for future transactions. If the trust funds are large in amount or are held for a long time, the attorney customarily deposits these monies in an interest-bearing account for the benefit of the client.

However, since significant amounts in attorney trust funds are "nominal in amount" or "held for a short period of time," it is often impracticable and uneconomical to establish interest bearing accounts with interest ac-

Copyright 1981 Randall C. Berg, Jr., Executive Director, Florida Justice Institute, Inc., Miami. The Institute is a public interest law organization primarily funded by the Edna McConnell Clark Foundation. The author assisted the Florida Bar Foundation's preparation of the 1981 Program's petition to the Florida Supreme Court, organized the support briefs, and currently is staff to the Implementation Commission and Bar Foundation. He argued for the Program before the Court on behalf of Florida's public interest law organizations. This article was prepared under contract with the Legal Services Corporation.

cruing to the individual client. Because attorneys are prohibited by trust principles from personally benefiting from any interest obtained, they have traditionally placed these "nominal" or "short-term" balances of trust funds in aggregated, non-interest-bearing, commercial bank checking accounts. The principal beneficiaries of such accounts are the financial institutions, which receive large sums of interest-free money for significant periods of time.

In states where an Interest on Trust Account Program is implemented, these otherwise idle funds may be aggregated in a trust savings' negotiable order of withdrawal (NOW) checking account. Allocating and accounting the interest to each client are not required. Instead, interest earned by an attorney's trust NOW account is paid over to a not-for-profit corporation (such as a bar foundation or association) to provide revenue for public interest law projects.

The Interest on Trust Account Program concept has enjoyed years of success in many common law countries and was well received in the United States when the original Florida Program was adopted in 1978.⁴ In February, 1979, the Conference of Chief Justices of the 50 state courts adopted a resolution endorsing Florida's Program and recommending its adoption in other states. Over 18 state bar associations, as well as the ABA's National Center for Professional Responsibility and the National Conference of Bar Foundations, have expressed an active interest in the Program. Florida, however, is the only state actually to have implemented the Program. The California Program should be implemented in early 1982.

The Florida Experience

The organized bar of Florida began investigating the Interest on Trust Account Program in 1971 as a means to provide funds to improve the administration of justice. Extensive data were gathered on other English-speaking jurisdictions with similar programs, and reports were developed on the feasibility of a Trust

Account Program for Florida. Activity on the Program accelerated in 1976, and the governing boards of the Bar and Bar Foundation approved the concept.

In 1978, after petition by the Board of Governors of The Florida Bar with the concurrence of the Board of Directors of the Florida Bar Foundation, the Florida Supreme Court issued an opinion establishing the Interest on Trust Account Program.⁵ Although that opinion effectively implemented the Program, significant obstacles remained—Internal Revenue Service (IRS) objections and federal and state banking regulations.

Tax counsel was retained by the Bar Foundation to resolve with the IRS the types of projects to be funded by Program proceeds and appropriate federal income tax treatment of the interest earnings. Although the IRS disapproved three of seven projects set forth in the Florida Supreme Court's 1978 opinion, it did approve the use of Foundation funds from the Program:

- to provide legal aid for the poor;
- to provide student loans;
- to improve the administration of justice; and
- for such other programs for the benefit of the public as are specifically

¹ See *In re Interest on Trust Accounts*, 402 So. 2d 389 (Fla. 1981).

² California Senate Bill No. 713 (1981).

³ The Oregon State Bar Association's Board of Governors recently voted to support the Legal Aid Committee's recommendation that a Program be implemented. The Program was approved by the Bar membership at its annual meeting on September 17, 1981. The Board of Governors now must approve the type of Program (mandatory or voluntary) prior to the Bar's petition to the Oregon Supreme Court. Washington, Idaho, Maryland, Massachusetts, the District of Columbia, Illinois, Nebraska, New York, Virginia, Hawaii, and others also have expressed interest in establishing a Program.

⁴ See Comment, *A Source of Revenue for the Improvement of Legal Services, Part I: An Analysis of the Plans in Foreign Countries and Florida. Allowing the Use of Clients' Funds Held by Attorneys in Non-Interest Bearing Trust Accounts to Support Programs of the Organized Bar*, 10 St. Mary's L. J. 539 (1979) for a list and description of jurisdictions with operational programs.

⁵ See *In re Interest on Trust Accounts*, 356 So. 2d 799 (Fla. 1978).

approved by the Court from time to time.⁶

Federal income tax treatment of the interest earnings remained the biggest obstacle to Florida's 1978 Program. Since the major portion of the Program involved the investment of client funds for the benefit of the Bar Foundation, the IRS raised a question regarding the "assignment of income" doctrine. Would income earned on the trust accounts be taxable to clients as an "anticipatory assignment of income," or as a "grantor trust?" If the "assignment of income" rule applied,

no degree control the creation or destiny of earnings generated on their attorney-held funds."⁷

Since the 1978 opinion, banking laws have changed to allow substantial improvement in operation of the Program. Congress and the Federal Reserve Board have recently authorized interest bearing NOW checking accounts, which are well suited to the Program.⁸ They eliminate the cumbersome "switch" accounts (interest bearing savings accounts subject to immediate availability through transfer to non-

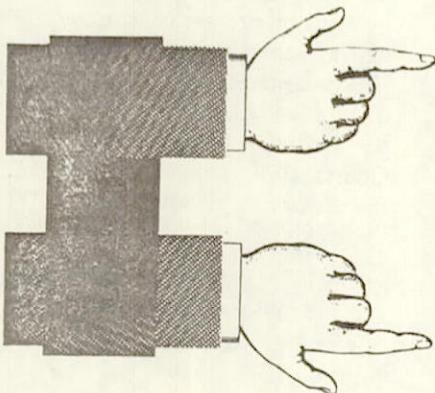
modifications of the Court's 1978 opinion:

- the Program was to be mandatory for all attorneys (eliminating client control over such funds, the main objection of the IRS);
- the "notice to client" provision was dropped because eliminating the client veto obviated its need;
- the use of NOW accounts was substituted for "switch" accounts, with all interest accruing to the Bar Foundation;
- the attorney remained free to invest client funds in interest bearing accounts with interest payable to a client whenever practicable; and
- if the Program resulted in any instances of attorney-client disputes, the Foundation would assist in their resolution and also bear the attorney's expense of compliance with the Program.

The Foundation's petition requested expedited consideration, with provisions allowing interested parties time to respond. The Court followed the Foundation's suggestion, gave notice to all members of the Bar, received numerous submissions, and held oral argument on June 2, 1981.

In its opinion of July 16, 1981, the Court carefully considered all concerns voiced by the Bar, as well as the tax issues and banking regulations involved. Major matters resolved by the Court for the 1981 Program included:

- **Creation of a Voluntary Program.** Attorneys have several options: (1) whenever practicable, continue to place trust funds in a separate, interest-bearing account,



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clients would be treated as having received income, thereby having to claim the interest as income and the amount given to the Bar Foundation as a charitable contribution. More importantly, application of the rule would impose a tax reporting requirement which would destroy the Program, since its justification is based on the premise that it is economically and administratively impractical to allocate the interest earnings of aggregated trust accounts to individual clients.

After three years of extensive negotiations, the IRS continued to view the Court's 1978 Program as involving a conceptual reassignment of interest income from clients to the Foundation, primarily because client participation was voluntary—clients could elect whether or not to participate in the Program. "Eventually, tax counsel was able to obtain firm assurances from the IRS that the tax treatment being sought for the program would be approved so long as the client could in no way and to

interest bearing checking accounts) which were to be used in the 1978 Program. A letter of counsel has been received from the Federal Reserve Board which ensures NOW account availability for all types of participating law firms—sole practitioners, partnerships, and professional associations—and for all deposits held in trust for individuals, partnerships, not-for-profit corporations, for-profit corporations, and others.⁹ The Federal Reserve Board ruling was predicated on a Florida Attorney General opinion letter that concluded that the Foundation holds the "beneficial interest" in the interest monies derived from trust accounts of attorneys and law firms participating in the Program.¹⁰

When the IRS assured their approval if minor amendments were made to the 1978 Program, the Foundation, later joined by the Bar, proposed Program amendments to the Florida Supreme Court for that purpose. The Foundation's petition in March, 1981, contained several major

⁶ The Florida Bar Foundation has not decided if it will continue to pursue IRS approval of the three projects that were earlier ruled not exempt. They are: (1) to provide for the adequate delivery of legal services to all members of the public; (2) to augment the clients' security fund with a view toward full reimbursement; and (3) to find a more expeditious and efficient grievance mechanism.

⁷ See *In re Interest on Trust Accounts*, 402 So. 2d 389, 391 (Fla. 1981).

⁸ See 12 U.S.C. §1832(a).

⁹ Fla. Bar News, Oct. 25, 1981, at 3.

¹⁰ Letter from Jim Smith to E. Albert Pallot, President of The Florida Bar Foundation (Aug. 21, 1981) (unpublished opinion of Florida Attorney General).

with interest payable to the client; and either (2) continue to place nominal or short-term deposits in an unsegregated, non-interest-bearing, demand trust account, or (3) begin placing nominal or short-term deposits in an unsegregated interest-bearing NOW account with the interest accruing to the Bar Foundation.

- **Elimination of Client Control.** The "assignment of income doctrine" problem with the IRS would hopefully no longer be pertinent since participation in the Program was left exclusively to the judgment of the attorney or law firm.

- **Elimination of Notice to Client Provision.** Elimination of client control obviated the need for the notice to client provision. Further, if an attorney elected to participate, the Court would not entertain a charge of ethical impropriety or other breach of professional conduct attending an attorney's exercise of judgment in that regard.

- **Disposition of Constitutional Issues.** There is no confiscation of clients' funds in violation of the "taking" provision of the Constitution. No client is compelled to part with "property" by state directive, since the voluntary Program creates income where there had been none before, and the income created would never benefit the client under any set of circumstances.

- **Participation by Attorneys.** The Court urged all members of the Bar to participate in the Program and reaffirmed its commitment to the delivery of legal services to the poor.

Immediately following IRS approval of the Program on August 31 and the Court's effectiveness date of September 1, a meeting was called to establish plans for implementing the Program.¹¹ A 15-member Implementation Commission was installed for this purpose, with 7 appointees from the Bar Foundation and 7 from the Bar, and a jointly appointed chairperson. The Commission has begun marketing the Program to enlist participation of all Bar members and to explain the Program to the public and financial institutions.

The California Experience

California's efforts to implement a Trust Account Program are strikingly different from Florida's and, thereby, provide a basis of comparison for Program implementation strategies in other states.

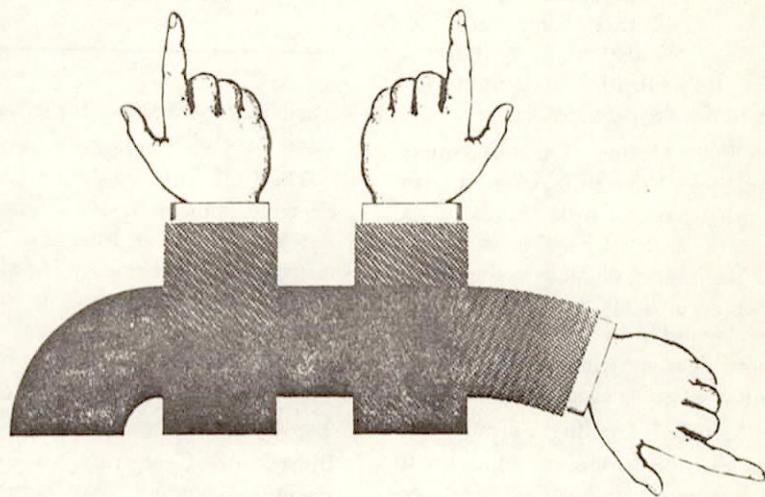
Discussion concerning possible implementation of a Trust Account Program in California began in 1976 when corporate lawyers from the State Bar investigated the feasibility of a State Bar Foundation. However, it was not until after Florida's 1978 opinion that the Program was seriously considered in California.¹² In 1979, the State Funding Committee of the Bar's Legal Services Section, composed primarily of legal services lawyers and public-interest-minded private attorneys, considered alternative funding sources for legal services to the poor. They decided to pursue a version of the Florida Program.

In 1980, the Committee drafted detailed Program legislation. Although the State Bar of California is an integrated bar, the Committee decided not to follow Florida's lead in petitioning the Supreme Court for a rule change to implement the Program. The Committee felt the Program would be better received by attorneys and the public, and its chance of passage greater, if instead it were mandated by the legislature.

Committee members then discussed the Program's legislation with key Board of Governors members. In 1981, the Board of Governors approved the proposed voluntary participation Program legislation, which was placed on the State Bar's legislative calendar as a priority item.

Legislative strategy also was formulated to ensure passage. First, the Committee sought sympathetic and influential legislators from key committees to sponsor and co-author the legislation. Second, the Committee and sponsoring legislators kept the bill out of as many committees as

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¹¹ Rev. Rul. 81-209.

¹² Information on the California Program was supplied by Robert J. Cohen, Chairman, State Funding Committee of the Legal Services Section and Harvey M. Freed, Director of Legal Services, The State Bar of California.

possible, for fear that it might be tabled or killed. They purposely did not add an appropriations section to the legislation so it could bypass the Appropriations and Fiscal Committees. These early tactical decisions, a well organized lobbying effort, and Bar sponsorship later proved key to the bill's eventual passage.

The legislative process that followed was amazingly swift. In 1981, the voluntary Program legislation was introduced in the Senate. The bill passed out of the Senate Judiciary Committee and proceeded to the floor. Just prior to Senate floor passage, the bill was amended to make participation even more voluntary than before.

As a result of the Senate amendments and the potential elimination of funding for the embattled Legal Services Corporation, the State Funding Committee, with the approval of the Board of Governors, amended the proposed Assembly bill to make participation mandatory.

The new, mandatory legislation was introduced in the Assembly, passed out of the Assembly's Judiciary Committee, and was approved on the floor. The Assembly's mandatory Program legislation then journeyed back to the Senate for conference and final approval on the Senate floor on September 13, 1981, during the waning days of the legislative session.

The California Program's legislation, substantially different from the Florida Program's Integration Rule, provides for:

- **Dual Option Trust Accounts (mandatory Program).** Attorneys can either (1) place trust funds in a separate, interest-bearing account, with the interest payable to the client; or (2) place clients' nominal or short-term deposits in an unsegregated, interest-bearing trust account, with the interest going to the State Bar.

- **Detailed Funding Formula for Legal Services Programs.** Funds are to be distributed to qualified legal services programs and support centers on the basis of the number of poor people in the state as a whole.

- **Law Students.** Some funds are to provide work opportunities with pay at qualified programs and, where

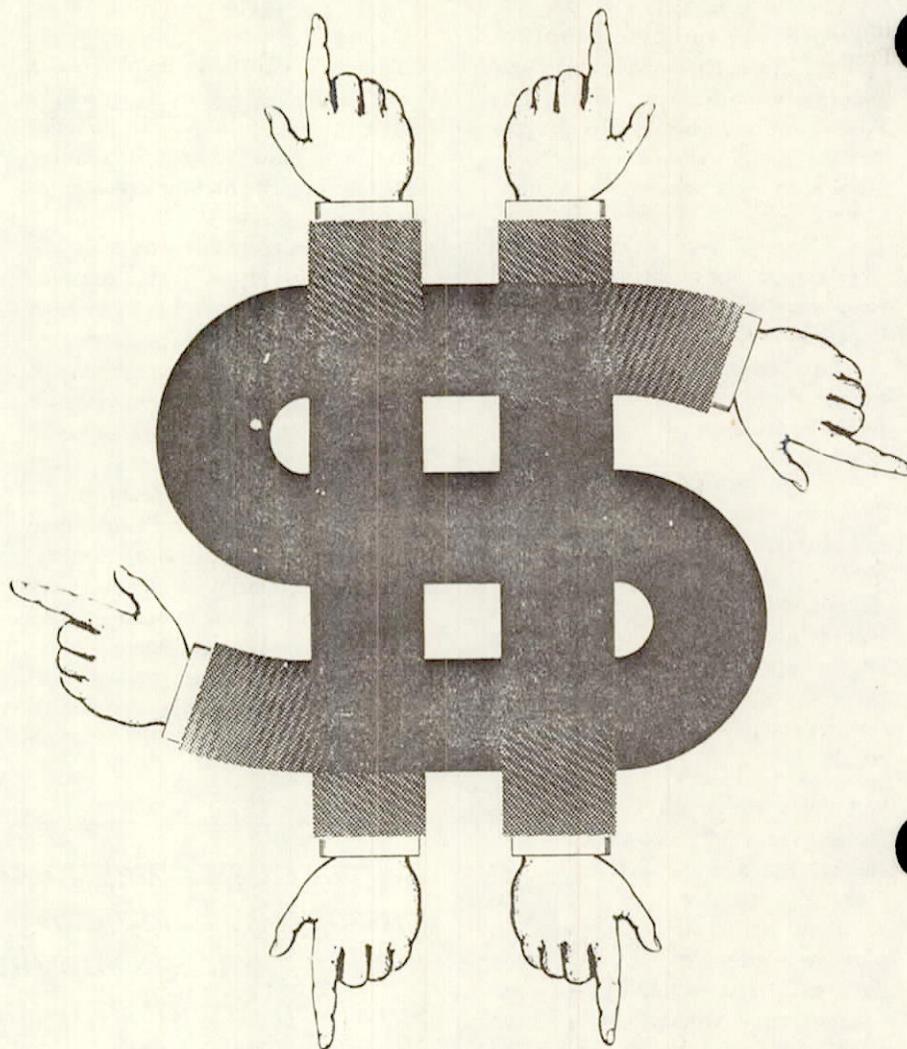
feasible, scholarships for disadvantaged law students.

The California legislation becomes effective January 1, 1982. The State Bar must hold at least two public hearings on the Program for affected and interested parties to present testimony concerning the Bar's draft regulations and procedures for the Program. The Program is not to be implemented until the State Bar's Board of Governors adopts a resolution stating that regulations conforming to all applicable tax and banking statutes, regulations, and rulings have been promulgated. Further, funds from the Program will not be distributed until mid-1983, or upon such date as is determined by the

State Bar that adequate funds are available to initiate the Program. The State Bar of California has assigned implementation of the Program to a committee. It is to draft the Program's rules and procedures, provide information for the public and financial institutions, and to do whatever else might be needed to ensure the Program's immediate implementation.

Recommendations To Other States

As governmental revenues for legal services to the poor dwindle, other states should seriously consider an Interest on Trust Account Program as an alternative funding source. The



revenues to be received should be substantial.¹³

Although the Florida experience in implementing a Trust Account Program was long and arduous, the legal work and precedents from this effort already have expedited the process in other states, as shown by California's swift approval. Now is the time to begin.

The Florida and California experiences have proven that careful consideration should be given to the following procedures in implementing a Program.

- **Collect literature on the Program.** The documents cited in the footnotes in this article should be all you will need to get started.
- **Become knowledgeable about the Program—the arguments in favor of and against it.**
- **Organize a small, diverse group of lawyers willing to commit a significant amount of pro bono time to creating the Program.** A state legal aid bar committee or existing bar foundation is a likely candidate.
- **Obtain pro bono commitment from a corporate law firm.** Even though Florida and California soon hope to resolve their remaining tax and banking problems, you may need corporate counsel assistance on certain tax and banking issues regarding your Program.
- **Obtain judicial support for the Program.** Prior to filing a trust account rule-change petition with the Court, through appropriate and ethical bar association channels or procedures, discuss possible judicial support for the Program. If the Program has to be approved by the legislature and does not require judicial approval, request an influential representative of the judicial system to testify in favor of the legislation before the applicable committees.
- **Prepare a memorandum on the Program.** The memorandum should contain an introduction to the Program; a review of the Program in other jurisdictions; the proposed structure and operation of the Program in your state; the procedure for implementation; and a timetable.

• **Obtain bar sponsorship and support at the outset.** Keep the governing board informed and involved. Board of Governors approval in Florida and California was important to each Program.

• **Carefully consider whether Program approval has to come from the legislature, the judiciary, or perhaps a combination.** This is an important legal and strategic decision. Since the Program is premised on the regulation of attorneys, determine which branch of government regulates the legal profession. The regulation of attorneys usually is determined by the state constitution. In Florida, Program approval was received from the Supreme Court. In California, Program approval was received from the legislature. (Some California commentators believe that either governmental branch could have approved the Program.)

• **Decide whether the Program's interest funds are to go to the bar foundation or the bar association.**

• **Decide whether a funding formula for allocation of Program funds is desired or if funds are to be allocated by the directors of the bar foundation (or association).**

• **Decide whether the Program is to be voluntary or mandatory.** Even though Florida's Program is voluntary and California's mandatory, a mandatory Program was approved by each bar's Board of Governors. A mandatory Program ensures greater revenues and obviates the voluntary Program's enlistment campaign for participating firms and attorneys. A voluntary Program can always be used as a fall-back position if the mandatory Program runs into opposition and is stalled. Later, if participants are not forthcoming, the voluntary program, perhaps, can be amended.

• **Draft the legislation or court rule and any corresponding ethical standards.** Florida's Integration Rule and California's legislation can be used as models.

• **Make certain Program legislation or court rule will meet IRS and state tax approval.** The Florida Program already has received IRS approval.

California will submit its legislation to the IRS for approval.

• **Try to obtain the support of financial institutions.** You may receive some opposition from the financial institutions' associations. Florida's Program did; California's did not. Their position is totally self-serving because they have historically received significant amounts of interest-free money for years. Some financial institutions or associations may be neutralized or even supportive if the Program is backed by sympathetic and influential general counsel and law firms to these

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Randall C. Berg

¹³ Because there are no records reflecting the aggregate average monthly balance of attorneys' trust accounts, the total estimated revenues from a particular state's Program is speculative. The amount also will depend on whether the Program is mandatory or voluntary. For example, in 1980, 5,300 participating trust accounts (11,000 attorneys) in Ontario Province, Canada generated \$8 million in interest. Proponents of California's Program estimate it will generate \$500 thousand to \$10 million in interest per year. In 1977, the Florida Bar estimated approximately \$16 million per year in revenue from a mandatory Program. Oregon's voluntary Program proponents estimate \$500,000 in annual revenues.

organizations. Maintain a good working relationship with these organizations because after the Program is approved, their assistance in establishing NOW accounts for the transference of funds to the bar foundation (or association) is important.

• If implementation of the Program is by court-rule petition, the most influential members of the bar should be among the petitioners. In Florida, the Program's petition to the Supreme Court was signed by the majority of the members of the Board of Governors, two past ABA Presidents, two former Governors, the Attorney General, several former Bar and Bar Foundation presidents, and many other prominent attorneys.

• Organize and submit support briefs on behalf of the petition. In Florida, support briefs were submitted to the Court on behalf of all public interest law organizations, the ABA, and the law schools.

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If approval is by legislation, (1) seek key legislators to be sponsors, (2) secure bar lobbying support, and (3) organize a grass-roots lobbying effort throughout the state.

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• Educate the public and bar membership about the Program. The Program is sometimes incorrectly per-

ceived by the public, and even the bar, as an attorney's charity "rip-off." Visits to news media editorial boards by local influential and sympathetic attorneys are essential for Program understanding and support.

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