



New York State Bar Association Committee on Professional Ethics

Opinion 934 (9/7/12)

Topic: Compensation of lawyer by law firm; third-party payments

Digest: A law firm may compensate a partner, associate or counsel by making a payment directly to the lawyer or to a professional services corporation as described in Article 15 of the New York General Business Law. A professional services corporation for the practice of law may not have non-lawyer shareholders. Consequently, a law firm may not pay a lawyer's compensation to a subchapter S corporation with non-lawyer shareholders. A law firm may make payments to a third party at the direction of the lawyer, as long as it does not treat such payment as payment for legal services. Thus, the firm may make payments to a Subchapter S corporation with non-lawyer shareholders, but neither the law firm nor the Subchapter S corporation may mischaracterize the payments as compensation for legal services.

Rules: Rules 1.0(h), 1.5(g), 5.4(a) and (d), 8.4(c).

QUESTION

[1] May a lawyer who has withdrawn as a partner in a firm, and who remains of counsel to the firm, receive compensation for the lawyer's legal services by check from the firm to a subchapter S corporation¹ in which the lawyer's spouse is a shareholder?

DISCUSSION

[2] Under Article 15 of the N.Y. Business Corporation Law, N.Y. Bus. Corp. Law § 1503, a New York lawyer, whether practicing as a sole practitioner or in a law firm, may practice law as a professional services corporation.² *See also* Rule 1.0(h)(defining "firm" or "law firm" to include a professional corporation).

¹ A subchapter S corporation is a creature of the Internal Revenue Code. In general, S corporations do not pay any federal income taxes. Rather, the corporation's income or losses are divided among and passed through to its shareholders. The shareholders must then report the income or loss on their own individual income tax returns.

² BCL § 1503 provides, in pertinent part, as follows:

(a) Notwithstanding any other provision of law, one or more individuals duly authorized by law to render the same professional service within the state may organize, or cause to be organized, a professional service corporation for pecuniary profit under this article for the purpose of rendering the same professional service ...

[3] Under § 1503 of the Business Corporation Law, however, a non-lawyer may not own any interest in a professional services corporation authorized to practice law. Thus the subchapter S corporation in this inquiry is not a professional services corporation authorized to practice law. *See also* Rule 5.4(d)(lawyer shall not practice with or in the form of an entity authorized to practice law for profit, if a nonlawyer owns any interest therein.)

[4] The law firm in this case may have occasion to pay the "of counsel" lawyer either as compensation for legal services rendered or as a return of the lawyer's capital contribution. If the law firm is willing to make payments to a third party at the direction of an employee -- for example to a creditor of the employee or, in this case, to the subchapter S corporation -- such a payment would not be prohibited by the Rules. The Rules do not prohibit a law firm from making payments to third parties, as long as they are accounted for properly, and as long as the payment does not constitute an impermissible sharing of a legal fee.³ Third party payments effectively are the same as payments by the firm to the lawyer with a second payment from the lawyer to the subchapter S corporation.

[5] The law firm's books and records may not mischaracterize the nature of the payments made -- that is, as compensation to the *lawyer* (not the Subchapter S corporation) for services rendered or return of the *lawyer's* capital contribution. Similarly, the lawyer, as a shareholder of the subchapter S corporation, may not mischaracterize the nature of the payments to the subchapter S corporation as compensation for legal services. See Rule 8.4(c) (a lawyer or law firm shall not engage in conduct involving dishonesty, fraud, deceit or misrepresentation). A payment for legal services would need to be made to the lawyer or a professional services corporation authorized to practice law in which the lawyer practices.

CONCLUSION

[8] A law firm may compensate a lawyer who is a partner, associate or counsel to the firm by making a payment directly to the lawyer or to a professional services corporation as described in Article 15 of the New York Business Corporation Law. Because a professional

(b) The certificate of incorporation of a professional service corporation ...(ii) shall have attached thereto a certificate or certificates issued by the licensing authority certifying that each of the proposed shareholders, directors and officers is authorized by law to practice a profession which the corporation is being organized to practice

Similarly, BCL § 1507 limits the issuance of shares by a professional services corporation to those individuals who are authorized by law to practice the profession that the corporation is authorized to practice.

³ The opinions of this committee have long recognized that a law firm may employ outside service providers. See, e.g. N.Y. State 95 (accounting service/data processor). However, the subchapter S corporation cannot provide legal services because of its non-lawyer ownership. And a lawyer may not share legal fees with a nonlawyer, with certain exceptions not relevant here. See Rule 5.4(a) ("A lawyer or law firm shall not share legal fees with a nonlawyer ..."). Moreover, a lawyer may not share legal fees with a lawyer outside the lawyer's own law firm, unless the relationship complies with Rule 1.5(g).

services corporation authorized to practice law may not have non-lawyer shareholders, the law firm may not treat as compensation a payment that it makes to a Subchapter S corporation in which a non-lawyer is a shareholder. The lawyer may direct the law firm to pay over the lawyer's compensation to a third party, including a Subchapter S corporation with non-lawyer shareholders, but neither the law firm nor the third party may mischaracterize such payment as a fee for legal services.

(1-12)