

Part 1. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Interest; attorney's trust account. Interest earned on clients' nominal and short-term advances deposited in an attorney's trust account and paid over to a bar foundation, pursuant to a program established by the Supreme Court of State X, is not includible in the gross incomes of the clients.

Rev. Rul. 81-209

ISSUE

Whether interest earned on client advances deposited in "trust accounts" under the circumstances described below is includible in the gross income of the clients.

FACTS

Attorneys in state X who are retained to render legal service must place in trust accounts monetary advances received in the ordinary course of their business. In many cases these advances are too small in amount and are on deposit for too short a time to permit, as a practical matter, deposit of funds in separate accounts for each client, or deposit in a commingled account with interest allocated to each client. As a consequence, the long standing practice of attorneys in state X is to deposit these small and short-term advances in commingled noninterest bearing checking accounts.

In 1981 the Supreme Court of state X reviewed this practice regarding client advances as a matter within its original jurisdiction regarding the discipline and practice of attorneys. The court concluded that for practical reasons interest could not be made available to the clients on advances that were nominal and held for short duration, and continued the practice of allowing attorneys to deposit these advances in noninterest bearing checking accounts. However, the court also concluded that such funds could be productive of income for charitable

purposes, and could be invested without violating the fiduciary relationship between attorney and client. Accordingly, the court established a program whereby an attorney could elect to commingle the nominal and short-term advances of all clients in an interest bearing trust account instead of a noninterest bearing checking account. Interest earned on amounts deposited in these trust accounts will be paid to the bar foundation of state X, a non-profit charitable organization described in section 501(c)(5) of the Internal Revenue Code.

The rights of the clients with respect to these advances will not be changed by the program; and no client may individually elect whether to participate in the program. If the attorney elects to participate in the program, the attorney must do so with respect to nominal and short-term advances of all clients. As with advances deposited in noninterest bearing checking accounts, advances deposited under the program continue to be readily available to attorneys for disbursement on behalf of clients. Under the program, all these disbursements for clients are in fact paid out of these trust accounts. The program bars clients from receiving the benefit of any interest earned to the commingled advances; and, because of their fiduciary responsibility to their clients with respect to any advances, it is illegal for the attorneys to receive any benefit from interest earned on the commingled advances. Furthermore, under the program, clients cannot compel attorneys to invest the advances on the clients' behalf.

HOLDING

Under the unique facts described herein, interest earned on clients' nominal and short-term advances and paid over to the bar foundation pursuant to the program established by the Supreme Court of X is not includible in the gross incomes of the clients.