

TAX DEDUCTABILITY AND LITIGATION: REDUCING THE IMPACT OF LEGAL FEES AND IMPROVING ACCESS TO THE SYSTEM

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Exorbitant legal fees, caused in part by time-based billing practices, are forcing many litigants to represent themselves in court. Invariably, the self-represented litigant is an individual or small business owner/operator who cannot afford the necessary legal assistance required to adequately defend or assert their rights in the current climate of exorbitant costs. Further lawyer-bashing will not provide an adequate solution to this problem. Instead, we must use this opportunity to create sustainable alternatives that ensure more equitable access to the litigation process. Any adequate solution must first address inequalities in the capacity to litigate; between corporations on the one hand, and individuals and small businesses on the other. One solution is to ensure that the tax deductibility of legal fees is consistent for all parties to litigation. Secondly, legal aid funding must be increased so as to ensure that a safety net is available to every litigant.

Faced with excessive fees, many litigants are failing to access legal representation in court proceedings, turning instead, in increasing numbers, to self-representation. The effect of this trend is clear; in that the costs of litigation are ultimately much higher. Where a party to proceedings is self-represented, the court incurs further costs because additional time is required to explain procedure and to ensure that sufficient consideration is given to the self-represented litigant. Because these proceedings are ultimately drawn out, often being required to address immaterial points raised by inexperienced self-advocates, the opposing party usually also incurs heightened expenses, particularly in a time-based billing environment. In this respect, the increase in self-representation impacts detrimentally on the system as a whole. It is also exceptionally difficult for the presiding judge to ensure fairness in proceedings between the parties when such a disparity in knowledge is evident.

In response to the increasing number of self-represented litigants and the large number of complaints about fees charged by legal professionals in NSW, the State Government and the legal profession have established the Legal Fees Review Panel, to investigate and report on the nature of legal costs by late 2004. The review will consider alternative billing methods to the current system and

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will '[e]xamine current legal costs, how they are calculated, how they are presented to clients and how clients can object to fees they consider unfair'.¹

The clear target of the review panel is the legal profession, and its preference for the time-based billing method. In reference to the formation of the review panel, Premier Carr noted that, '[e]veryone has an anecdote about a lawyer handing them an outrageous bill after a relatively small matter'.²

While it is essential that potential litigants are provided with clear and easily comprehensible information up-front, about the risks and potential costs of their litigation, the review must also consider far-reaching solutions to this problem. The Premier's attitude towards the legal profession is demonstrably clear. In his view, it seems, lawyers themselves are responsible for the high cost of litigation. While this may well be true in part, there are far more substantial elements at work, particularly the ability of litigants to absorb the costs that they are presented with.

The complexity of this issue was recently highlighted by Chief Justice Spigelman, who sparked debate on the subject during his address at the opening of the Law Term. He recognised that the problems associated with time-based billing are evident and well documented noting that, '[i]n many areas of litigation, the costs incurred in the process bear no rational relationship, let alone a proportionate relationship, to what is at stake in the proceedings'.³

However, while critical of the fees charged by lawyers in this context, and while acknowledging the 'reward for inefficiency'⁴ that time-based billing may provide, his Honour went on to emphasise that this is a relatively small problem in the big picture, with only a minority of lawyers abusing the billing system:

Only a handful of members of the profession exploit their position by providing services that either do not need to be provided at all, or provide them in a more luxurious manner than is appropriate.⁵

The real problem is that this system is allowed to flourish, as most expenditure on litigation is funded by corporations, for whom little or no cost is ultimately incurred. In the current environment, taxpayers ultimately bear the cost of time-based billing. It is a system that clearly favours the corporation over the individual. For corporate litigants, the system of time-based billing is an effective one; for these litigants, legitimate legal expenses may be claimed as tax deductions, and as a result, time-based billing provides an easily explainable method of expenditure that delivers cost-effective business results. Yet in this regard, the system is unequal in its application to individuals and small businesses. For these litigants, it is usually either unlawful to deduct fees in this

1 See Alex Mitchell, 'Watchdog to Sniff-Out Greedy Lawyers', *The Sun Herald* (Sydney), 15 February 2004, 5.

2 Ibid.

3 The Hon J J Spigelman, Chief Justice of the Supreme Court of NSW, 'Opening of the Law Term 2004' (Speech delivered at the Opening of the Law Term Dinner, Sydney, 2 February 2004) <http://www.lawlink.nsw.gov.au/sc%5Csc.nsf/pages/Spigelman_040202> at 6 July 2004.

4 Ibid.

5 Ibid.

manner, or the scale of the business enterprise in question is too small to make this approach viable.

A necessary first step in ensuring equal access to the litigation process, and in reducing the impact of legal fees, would be to address this basic inequality in deductibility of fees. The Legal Fees Review Panel must not confine its scope to fees payable and methods of calculation, but must also examine the broader impact of legal costs on the parties to litigation. In reviewing the problem of costs, it must take into account the varied perspectives of litigants, recognising their differing capacities to litigate.

Two immediate solutions to this inequity come to mind. Either, the tax-deductibility of legal fees must be removed across the board, or alternatively, individuals, sole traders, and others must be allowed the same privilege enjoyed by corporations in deducting their legal fees from taxes payable. The second alternative is clearly the one that is likely to deliver a more equitable outcome.

One likely result of any change in this area is that parties with proper representation and advice may become more likely to settle matters rather than resorting to litigation. Another likely result is that the playing field in terms of cost may become more level, resulting in fairer outcomes, which reflect adequate argumentation of the issues in dispute, rather than outcomes which are decided by the relative stamina of parties in wearing increasing legal costs.

Of further concern is the continuing decline in accessibility of legal aid for civil litigation. It is fundamental to the protection of people's rights in civil litigation that legal aid is provided as a safety net for potential litigants. First, access to legal advice up-front can reduce costs as it assists in the prevention of unnecessary litigation, as people are informed of their standing in a matter and the likelihood of success. Secondly, it ensures that people without the capacity or means to litigate, but with meritorious claims, are able to assert or defend their rights. In any review that seeks to address the high cost of litigation, consideration must be given to providing legal assistance for people to litigate effectively. The cost of litigation should not be the primary factor in determining whether to do so or not. Any decision to litigate should be made on the merits of the action.

When looking to solve the problem of high legal costs we must examine not only simplistic factors such as billing methods, or easy targets such as blaming the legal profession. We must look into the underlying problems that lead to cost and consider the solutions required to ensure that access to litigation is equitable. Equity in litigation requires much more than a review of fees and the reasons for them. It requires a reassessment of the ability of parties to deduct fees that they may incur. It also, more importantly, requires governments to commit to the provision of adequate and accessible legal aid for parties who otherwise would be denied the ability to litigate. In many cases even the most efficient and fair billing arrangements will not assist people who simply cannot afford to litigate.