

WINTER 2022

LAW FIRMS & LEGAL SERVICES

Quarterly Industry Newsletter

Tax Season is upon us...

You may begin to see a lot more forms on your desk, questions from your CPA or just need some guidance. We can help.

Upcoming dates

- **March 15**
 - Due date for partnership and S corporation tax returns (Forms 1065, 1120S)
- **Reminders**
 - Daylight saving time begins Sunday, March 13



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The Secret to a Quick Tax Refund

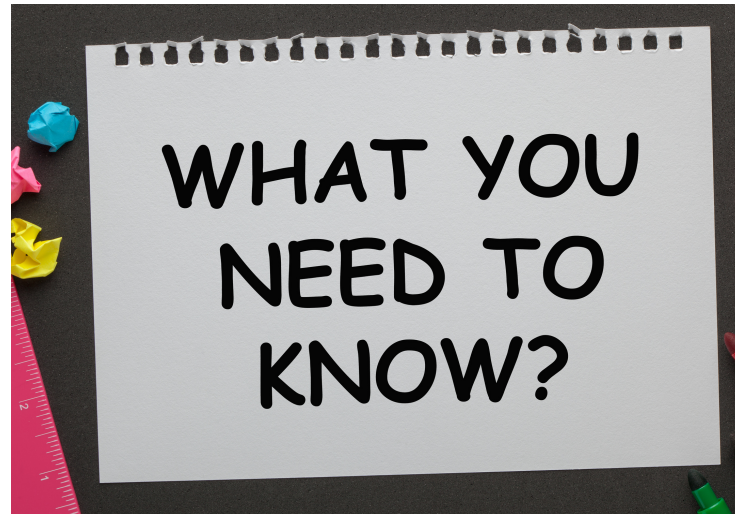
Here's how to get your overpayment as soon as possible

Delayed tax refunds, penalties for not filing 2020 tax returns on time that were actually filed on time, and timely tax payments being flagged as late are just some of the headaches taxpayers are grappling with due to a massive backlog of several million unprocessed tax returns the IRS is trying to wade out from under.

Here's how to avoid getting your tax refund delayed and steer clear from late-filing and payment penalties resulting from the IRS backlog:

What you need to know

- **E-file your return!** The secret to getting a quick tax refund is to e-file your 2021 tax return! The IRS says approximately 90% of the more than 160 million individual tax returns expected for the 2021 tax year will be e-filed. The majority of these taxpayers will avoid any issues filing their return and getting their refund. If you do e-file, don't forget to sign Form 8879, which authorizes the e-filing of your return.
- Stay calm if you receive a letter from the IRS. You may receive an IRS notice indicating you have an unfiled tax return or that you have an unpaid balance on your account. If the notice was mailed because of the backlog and you indeed filed the tax return in question or paid the amount due listed, the IRS says there is no need to call or respond to the notice as it's continuing to process prior year tax returns as quickly as possible.



- Certified mail is your friend. If you receive an IRS notice for a situation not related to the backlog, you'll want to respond in a timely fashion via certified mail. This will provide proof of your timely correspondence. So even if your response gets lost or caught up in the backlog, you'll have evidence that you responded by the deadline listed on the notice. Remember that delays in responses could generate penalties and additional interest payments.
- Be patient if you need to talk with the IRS. The IRS received a record 282 million phone calls during its 2021 fiscal year, according to National Taxpayer Advocate Erin Collins. Only 32 million of these calls were answered. Collins said the best time to call the IRS are Wednesdays through Fridays, especially early mornings starting at 7 am Eastern time.

Executive Summary

Law abiding: Strengthening business activity and corporate profit will help drive growth

Operators in the Law Firms industry range from sole practitioners to large, full-service legal firms mostly serving corporate clients. Industry revenue growth has been modest over the five years to 2021. Although the industry benefited from economic growth through most of the period, it was negatively affected by the COVID-19 (coronavirus) pandemic in 2020. Overall, industry revenue has increased at an annualized rate of 1.2% to \$329.7 billion during the current period, including an increase of 5.3% in 2021 alone.

Greater demand for practices tied to high-growth sectors has boosted industry revenue over the past five years. Industry revenue growth has been primarily due to growth in demand for litigation, intellectual property and merger and acquisition (M&A) services. However, as the coronavirus pandemic ravaged the economy in 2020, many operators saw declines in revenue as downstream clients cut costs due to uncertainty and reduced demand. Nonetheless, revenue declines were mitigated by services that run countercyclical to the economy.

For example, an uptick in bankruptcy filings and labor and employment disputes related to the economic downturn helped ameliorate the overall economic contraction. In particular, demand from the private equity and M&A markets bolstered revenue for top firms in 2020. Industry profit remained stable overall during the five year period as declines in revenue have been offset by reduced costs as a result of remote work by law firms. In 2021, the industry as a whole is expected to benefit from broad-based economic growth and resumption in spending by downstream businesses and households.

Industry revenue is forecast to increase an annualized 1.0% to \$347.0 billion over the five years to 2026 largely due to stronger economic performance. An increasing number of mergers and acquisitions (M&As), coupled with heightened initial public offering (IPO) activity and broad-based economic growth, is expected to support revenue growth for the industry over the five years to 2026. Delayed business activities requiring legal services, such as capital raisings, will likely resume over the next five years, while rising disposable income is expected to aid smaller operators by increasing demand for services such as family law. In addition, improving investor confidence will likely stimulate more activity in IPO markets, facilitating higher demand for corporate legal services.



*Please call to
discuss these
and other tax
planning
opportunities.
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Easy-to-Overlook Tax Documents

This year is a little more challenging

With tax season now officially underway, here are several tax documents that may be easy to miss in your mailbox or inbox:

Child tax credit letter. From July through December 2021, the IRS paid out 50% of projected child tax credit payments to qualified households. The IRS is sending out a recap of these advance payments in Letter 6419 that you can use to correctly account for these payments on your tax return. This letter should have arrived in your mailbox by late January.

Stimulus payment letter. The IRS issued millions of economic impact payments in 2021. The IRS is mailing a summary of these payments you received in Letter 6475. As with the child tax credit letter, you can use this letter to accurately report your economic impact payments on your tax return. This letter also should have arrived in your mailbox by late January.

Identification PIN. The IRS may have assigned you an Identity Protection PIN (IP PIN) to help protect your identity. An IP PIN is a six-digit number that prevents someone else from filing a tax return using your Social Security number or Individual Taxpayer Identification Number. This IP PIN is known only to you and the IRS. If you are a confirmed victim of tax-related identity theft and the IRS has resolved your tax account issues, the IRS will mail you a CP01A Notice with your new IP PIN each year.

Corrected tax forms. If an error is discovered on a tax form you've already received, a corrected version will be created, then mailed to both you and the IRS. You can also request a corrected tax form if you believe you found an error. Here are some of the forms you might see with corrections:

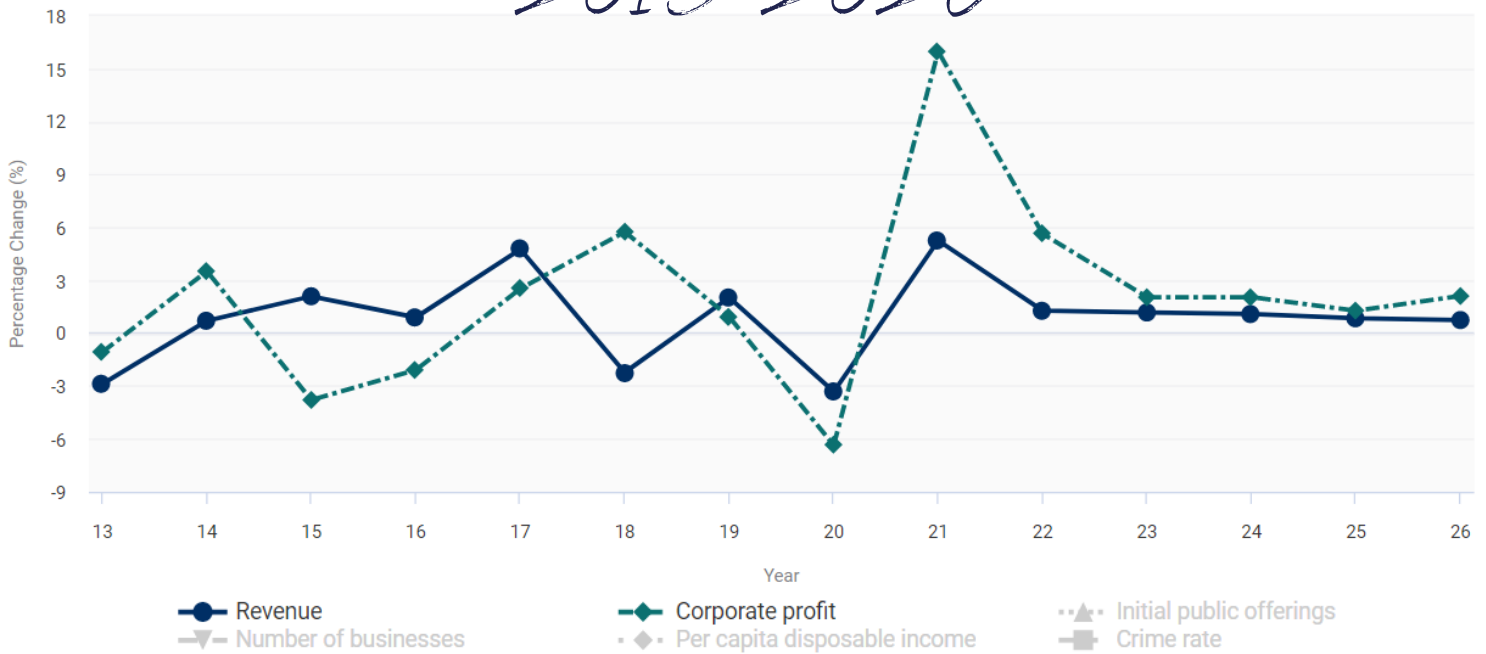
- Form W-2 from your employer that shows corrected wages, salary and taxes withheld
- Form 1099-INT or Form 1099-DIV from your investment broker that shows a revision in interest and dividend income
- Form 1099-NEC from a client to whom you provide services
- Form 1098 that shows how much mortgage or student loan interest you've paid

You may not be aware you were issued a corrected tax form until it shows up in your mailbox (or inbox). If you do receive a corrected form, don't throw the old version away! Save both the original version and corrected version in case either are needed for future reference.



KEY EXTERNAL DRIVERS

2013-2026



Corporate profit

Downstream businesses are more likely to engage in high-cost litigation when corporate profit is high. Furthermore, strong corporate profit stimulates IPOs, M&As and capital-raising activity, which all require legal services. Corporate profit is expected to increase in 2021, representing a potential opportunity for the industry.

Per capita disposable income

While the commercial market plays the largest role in determining industry revenue, demand from households also figures prominently because households require legal services for issues ranging from divorce, estates and trusts, child custody and personal property damage. Per capita disposable income is expected to increase in 2021.

Number of businesses

The largest downstream market for law firms is the business and corporate sector. An increase in the number of businesses with employees tends to lead to an increase in demand for associated legal services. The number of businesses is expected to decrease in 2021, posing a potential threat to the industry.

Crime rate

An increase in the rate of reported crimes leads to higher demand for prosecution and, as a result, industry revenue tends to increase with the crime rate. Over the past 20 years, the crime rate has been in secular decline for reasons that are not well understood. The crime rate is expected to continue declining in 2021.

Initial public offerings

Many major law firms receive significant fees from work on IPOs, M&As and capital-raising activity. As investment activity increases, industry revenue rises. IPOs are expected to increase in 2021.

INDUSTRY OUTLOOK

Revenue for the Law Firms industry is forecast to increase at an annualized rate of 1.0% to \$347.0 billion over the five years to 2026.

A projected increase in corporate profit as the economy recovers will likely drive industry demand from businesses during the outlook period. At the same time, improving investor confidence is expected to stimulate M&A and IPO activity. Specifically, the value of IPOs is expected to increase at an annualized rate of 1.6% over the five years to 2026. This increase will likely spur revenue growth for the industry's largest firms, which aid corporations in deals and equity offerings. Moreover, an increase in corporate litigation activity, which generates a sizeable share of revenue for large firms, is projected to be positive growth factor for the industry. Businesses that delayed legal issues in 2020 due to cost-cutting measures amid the coronavirus pandemic are anticipated to resume use of industry services over the next five years, boosting industry revenue. As businesses continue to be digitized and cybersecurity issues continue to remain prominent, IP litigation and technology sector antitrust and data-related litigation will continue to drive demand for industry services.

From the consumer sector, demand from households is expected to increase as employment increases and disposable incomes grow. Households will likely use industry services for estate planning, family law and litigation, among other things. Similarly, an increase in construction activity, which drives demand for industry real estate law services, is forecast to benefit the industry as private nonresidential construction activity resumes and there is continued growth in the residential construction market.

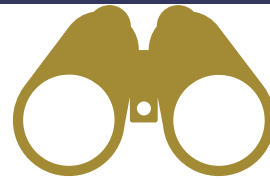
The industry's largest firms are expected to continue expanding overseas operations in emerging markets over the next five years.

Law firms have commonly gained a foothold in high-growth regions, such as China and Indonesia, through M&As and partnerships. In particular, more mergers and expansions into African markets are expected to take place among global firms over the next five years. Due to a combination of its size, the fact that the continent's economy is expected to grow significantly over the course of the 21st century and its deeper anticipated integration with the global economy, the region is an attractive market for M&As.



INDUSTRY OUTLOOK

Continued...



In addition to international expansions, more domestic mergers are anticipated to take place during the outlook period. Many midsize law firms, which include practices with fewer than 50 employees, will likely pursue expansions into new US regions. Firms typically perceive mergers as a quicker, more efficient means of expansion than opening new offices, hiring new employees and establishing local recognition for service. However, despite M&A growth, new law firms continuously enter the market, partially as a result of sole proprietors entering the market. As a result, the number of industry enterprises is forecast to rise at an annualized 0.8% to 461,228 companies over the next five years. Similarly, industry employment is projected to increase at an annualized 0.9% to 1.4 million employees.

Billing trends

Industry operators have adopted price competition and alternative billing schedules to attract more clients and differentiate themselves from other firms.

Although downstream market improvements will likely lead to industry revenue growth over the next five years, competition and a desire to attract clients through alternative methods is expected to continue. Such practices have the potential to put downward pressure on fees, resulting in lower industry revenue. Moreover, for large firms that saw an increase in profitability in 2020 due to reduced operating costs amid the coronavirus pandemic, downstream businesses may seek price concessions from industry operators. Increasing use of artificial intelligence to automate certain mundane and repetitive tasks that have traditionally been time-consuming may also reduce billable hours. While this could lead to a reduction in industry revenue, it will likely free up operators to spend more time on productive tasks and make legal services more cost-efficient for downstream businesses.

Competition from substitutes

Competition from nonlegal professionals is anticipated to increase over the next five years.

A factor that could constrain industry revenue growth is the commoditization of legal work. User-friendly online tools for drafting legal documents have created generic legal solutions for common services, such as wills and employment agreements. The availability and low cost of these products may pose a threat to smaller law firms, which have historically relied on these services for income. According to the 2020 Altman Weil survey, 28.9% of respondents said client use of technology that reduces the need for lawyers and paralegals was taking business from them. Additionally, the use of virtual lawyers could present a threat to demand for brick-and-mortar law firms. This will likely become more prevalent as online legal tools have become increasingly popular. This trend accelerated in 2020 as businesses and individuals transitioned to video-conferencing due to the coronavirus pandemic, and is likely to persist in the future due to the increased convenience for clients.

PRODUCTS & MARKETS

Commercial law services

In 2021, commercial law is estimated to account for 49.5% of industry revenue.

Practices in this area include financial deal-making and restructuring, such as merger and acquisition activity; capital-raising involving debt and equity markets; activities relating to initial public offerings; and legal services associated with private equity transactions that include leveraged buyouts and the securitization of credit derivatives. These law services are largely procyclical and depend on the health of the economy and the level of investor optimism. For example, revenue from corporate deal-making surges during periods of economic growth and sound market performance. During periods of economic distress, bankruptcy and insolvency work increases, helping to mitigate the reduction in revenue from other sources. Acquisition activity in the private equity market also tends to countercyclically buffer industry revenue. Corporate intellectual property law is another major contributor to commercial law services that has been an important source of industry revenue from technology firms.

Over the five years to 2021, revenue from this segment has increased slightly as a share of industry revenue. Amid the economic downturn caused by the COVID-19 (coronavirus) pandemic, demand from businesses has declined somewhat, as businesses cut expenses where possible. However, a surge in private equity market activity and mergers and acquisitions largely compensated for the decline in spending by smaller industry clients, leading this service segment to increase as a share of industry revenue. Moreover, this market segment is expected to be positively affected by broad-based economic growth in 2021.

Criminal, civil negligence and personal injury

The criminal law, civil negligence and personal injury segment is estimated to account for 16.5% of industry revenue in 2021.

The most common form of civil negligence is personal injury claims, which are filed for incidents such as traffic accidents, workplace accidents, assaults, accidents in the home, defective product-related accidents and medical malpractice. This segment's share of industry revenue has declined over the past five years due to a continuously falling crime rate in the United States, although demand for civil negligence and personal injury services has remained strong.

Real estate law

Real estate law accounts for an estimated 11.2% of industry revenue in 2021.

This segment includes services related to property transactions and the use and enjoyment of land and man-made structures. This segment has moved in line with growth in the commercial and residential real estate markets over the five years to 2021. Amid the coronavirus pandemic, an increase in housing market activity has buoyed demand for this legal service segment.



CONTINUED...

Labor and employment law

In 2021, legal services related to labor and employment law account for an estimated 8.6% of industry revenue.

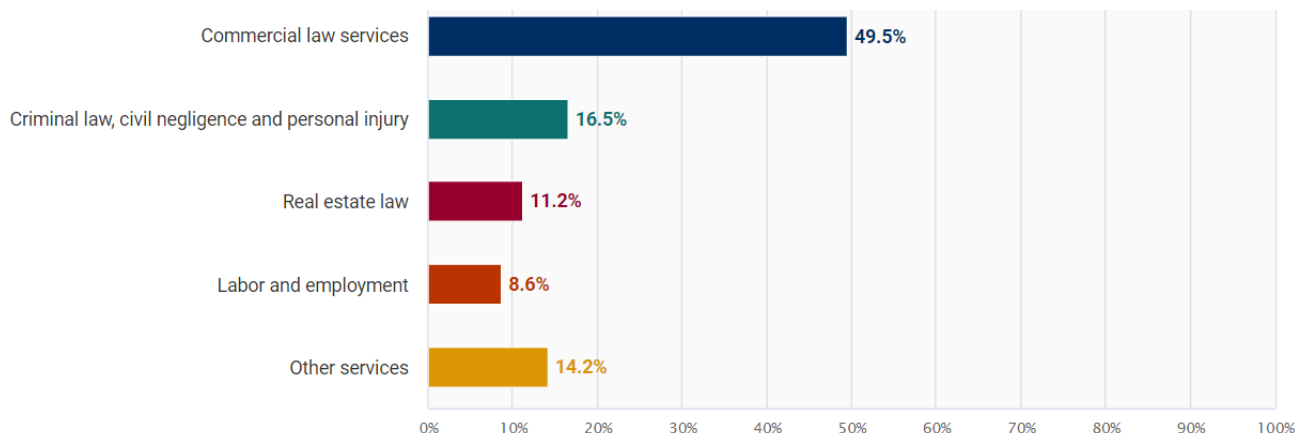
Employment law encapsulates a variety of topics including employee pensions and benefits and discrimination and sexual harassment, while labor law centers on contract disputes and issues related to collective bargaining. This segment has increased as a share of industry revenue over the past five years because of high unemployment amid the coronavirus pandemic. As individuals have been laid off due to the coronavirus pandemic and its effect on the economy, laid-off workers have filed suits against their employers in higher-than-usual numbers. In 2021, this trend is expected to diminish, however, as many individuals are able to return to work and layoffs become less prevalent.

Other services...

Other legal services account for an estimated 14.2% of industry revenue in 2021.

Major categories within this segment include wills, estates and trusts law, which relates to suits involving paternity, custody and divorce; immigration law; healthcare law; environmental law; legal research document services, including copyright and patent law for individuals; and arbitration and mediation. There are many factors that drive demand for these legal services. For example, an increase in the average age of the United States population affects wills and estate activity. The increase in mortality amid the coronavirus pandemic has increased demand for wills and estate services, leading this segment's share of industry revenue to increase slightly over the past five years. Over the coming years, demand for wills and estate activity is forecast to increase as more baby boomers reach retirement age. Additionally, while US divorce rates have declined during the past five years, rising disposable income levels have increased the affordability of divorce law services and have led to a slight increase in demand for attorneys specializing in family law.

2021 Industry Revenue
\$329.7 b



I Owe Tax on That?

5 Surprising Taxable Items

Wages and self-employment earnings are taxable, but what about the random cash or financial benefits you receive through other means? If something of value changes hands, you can bet the IRS considers a way to tax it. Here are five taxable items that might surprise you:

Scholarships and financial aid. Applying for scholarships and financial aid are top priorities for parents of college-bound children. But be careful — if any part of the award your child receives goes toward anything except tuition, it might be taxable. This could include room, board, books, travel expenses or aid received in exchange for work (e.g., tutoring or research).

Gambling winnings. Hooray! You hit the trifecta for the Kentucky Derby. But guess what? Technically, all gambling winnings are taxable, including casino games, lottery tickets and sports betting. Thankfully, the IRS allows you to deduct your gambling losses (to the extent of winnings) as an itemized deduction, so keep good records.

Social Security benefits. If your income is high enough after you retire, you could owe income taxes on up to 85% of Social Security benefits you receive.

Alimony. Prior to 2019, alimony was generally deductible by the person making alimony payments, with the recipient generally required to report alimony payments received as taxable income. Now the situation is flipped: For divorce and separation agreements executed since December 31, 2018, alimony is no longer deductible by the payer and alimony payments received are not reported as income.



Unemployment compensation.

Congress gave taxpayers a one-year reprieve in 2021 from paying taxes on unemployment income. Unfortunately, this tax break did not get extended for the 2022 tax year. So unless Congress passes a law extending the 2021 tax break, unemployment will once again be taxable starting with your 2022 tax return.