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Senator Tillis Introduced a Bill Taxing Proceeds of Litigation Financing Agreements

Tax Talks on **June 2, 2025**

Senator Thom Tillis introduced a bill (called the "Tackling Predatory Litigation Funding Act") that would impose additional significant taxes on litigation funding investments. Rep. Kevin Hern (R-OH) introduced a similar bill in the House of Representatives. The bill would apply to taxable years beginning after December 31, 2025, which could include future payments related to existing arrangements.

The following is a summary discussing the key points of such proposed legislation.

1. **General Rule:** A tax equal to the highest individual rate plus 3.8% (37% + 3.8%, or 40.8% under current law) would be imposed on any qualified litigation proceeds received by a covered party.
2. **Covered Party:** A covered party for these purposes includes any third party to a civil action which receives funds pursuant to a litigation financing agreement and is not an attorney representing a party to such civil action. If the covered party is a partnership, S-corporation or other pass-thru entity, the tax would be imposed at the entity level. If a U.S. corporation is a covered party receiving qualified litigation proceeds, it would be subject to a 40.8% in lieu of the normal 21% tax. The tax also applies to tax-exempt U.S. investors and non-U.S. investors, including investors described in section 892 of the U.S. Internal Revenue Code. The tax apparently applies even if the non-U.S. investor has no connection to the United States, although we are unsure whether this was intended. There is no apparent "treaty override" so investors that benefit from a tax treaty with the United States may be able to rely on the treaty.
3. **Qualified Litigation Proceeds:** Qualified litigation proceeds mean, with respect to any taxable year, an amount equal to the realized gains, net income or other profit received by a covered party during the taxable year which is derived from, or pursuant to, any litigation financing arrangement. These gains, income or profit are not reduced by any ordinary or capital losses, which could include losses from another litigation funding investment. This definition is not limited to U.S. source litigation proceeds, so it could include proceeds from non-U.S. litigation funding investments.

4. **Litigation Financing Agreement:** A litigation financing agreement is with respect to any civil action, administrative proceeding, claim or cause of action (collectively, a "civil action"), a written agreement (A) (1) where a third party agrees to provide funds to one of the named parties or a law firm affiliated with the civil action and (2) which creates a direct or collaterized interest in the proceeds of such civil action which is based, in whole or part, on a funding-based obligation to the civil action, the appearing counsel, any contractual co-counsel or the law firm of such counsel or co-counsel and (B) that is executed with any attorney representing a party of such civil action, any co-counsel in the litigation with a contingent fee interest in the representation, any third party that has a collateral based interest in the contingency fees of the counsel or co-counsel which is related to the fees derived from representing such party or any named party in the civil action. This term can also include any agreement which, as determined by the Secretary of the Treasury, is substantially similar. We believe this definition will apply to virtually all litigation funding agreements regardless of the form of the agreement (e.g., loan, option, forward, swap etc.). For purposes of these rules, the term "civil action" may include more than one civil action.

5. **Exceptions:** Litigation funding agreement does not include: (1) any agreement under which the total amount of funds provided with respect to an individual civil action is less than $10,000, (2) any agreement under which the third party providing funds has a right to receive proceeds from the agreement that are limited to (x) repayment of principal on a loan, (y) repayment of principal plus interest as long as the interest does not exceed the greater of 7% or a rate equal to twice the average annual yield on a 30 year U.S. Treasury security or (z) reimbursement of attorney's fees, or (3) the third party providing the funding bears a relationship as described in section 267(b) to the named party (e.g. generally includes two corporations that are members of the same controlled group or two entities that have 50% ownership overlap). We believe that these exceptions will be of only very limited use.

6. **Withholding:** The parties having control, receipt or custody of the proceeds from a civil action with respect to which such person has entered into a litigation financing agreement must withhold from such proceeds a tax equal to 50% of the applicable percentage (which would be a withholding rate of 20.4% under current law) of any payments which are required to be paid under such agreement. This withholding amount is based on any payments required to be made, which could result in over-withholding because the withheld amount is not reduced by the original amount funded. This withholding obligation appears to apply to any party in the world, even if the party has no connection to the U.S. and is making a payment to another non-U.S. person in respect of litigation that is outside of the United States. We do not know whether this extraordinarily broad scope was

intended.

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