



The State Bar *of California*

OPEN SESSION AGENDA ITEM 703 MAY 2019

DATE: May 17, 2019

TO: Members, Board of Trustees

FROM: Leah Wilson, Executive Director
John Adams, Chief Financial Officer

SUBJECT: Fee Scaling Options for Implementation of State Bar Fee Increase

EXECUTIVE SUMMARY

This agenda item provides the Board of Trustees (Board) with updated options for enhanced fee scaling to be applied should a sizeable fee increase be authorized by the Legislature, and requests authorization for staff to incorporate the proposed scaling option into the fee increase methodology and related communication and legislative advocacy efforts.

BACKGROUND

At its March 2019 meeting, the Board considered the impact of a licensing fee increase on low-to-moderate income attorneys, and reviewed options presented by staff for modifying the State Bar's current scaling procedures to address concerns about the impact of a fee increase on certain segments of the attorney population. Staff has conducted additional research and analysis and seeks the Board's authorization to adopt a fee scaling model that expands the eligibility for fee scaling to attorneys based on income. Additional possible scaling population expansions, to specifically include attorneys who work for non-profit organizations and active duty military, are also addressed in this agenda item.

DISCUSSION

Staff's current proposal is informed by research done on other states and licensing agencies, as outlined below.

REDUCED LICENSING FEES IN OTHER STATES

While only 3 states other than California provide specific guidelines for fee reductions based on income, 20 provide for reduced fees for newly licensed attorneys, 38 (including California) reduce or waive fees for those whose license limits them to providing pro bono services, and 9 states reduce or waive fees for attorneys on active military duty. In addition, 13 states

(including California) have procedures for attorneys to apply for a reduction or waiver based on individual circumstances. These “hardship” applications are considered on a case-by-case basis, with no published guidelines governing the basis for approval or denial of the application. Table 1 provides information about fee reductions provided in other states.

Table 1. Attorney Licensing Fee Reductions

Basis for Reduced Fee	States	Details
No reduced fees	Alabama, Alaska, District of Columbia, Florida, Indiana, Maryland, Michigan, New Jersey	N/A
Emeritus/Pro Bono	Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Minnesota, Montana, Nevada, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming	Licensing fee is reduced or waived for attorneys whose practice is limited to providing pro bono services.
First years admitted	Arizona, Delaware, Hawaii, Idaho, Illinois, Kentucky, Louisiana, Maine, Massachusetts, Mississippi, Missouri, Nevada, New Hampshire, North Dakota, Rhode Island, Texas, Utah, Washington, Wisconsin, Wyoming	Licensing fee is reduced for the first 1 to 5 years that attorney is admitted. ¹ Reductions range from 8% to 69%, with some states waiving fees for the first year an attorney is admitted.
Low-Income	California, Connecticut, Minnesota, Washington	Licensing fee reduced or waived for attorneys with less than specified income level: <ul style="list-style-type: none"> • <\$1,000 legal practice income (waived in Connecticut) • <\$25,000 individual income (11% reduction in Minnesota) • ≤200% FPL household income (waived in Washington; waiver only available for one year)
Hardship	Arizona, California, Illinois, Louisiana, Maine, Mississippi, Missouri, Montana, New Hampshire, Oklahoma, Oregon, Texas, Wyoming	Applications for fee reductions/waivers are considered on a case by case basis, with no published guidelines.
Active Duty Military	Connecticut, Illinois, Louisiana, Maine, Mississippi, Montana, New Hampshire, Oklahoma, Oregon	Licensing fee is reduced or waived for attorneys on active military duty.

REDUCED FEES FOR CALIFORNIA LICENSED PROFESSIONALS

¹ Based on admission in any state.

Table 2 provides information about reduced fees available to doctors, dentists, and nurses, considered to be categories of professionals comparable to attorneys for the purpose of this analysis. As shown in Table 2, reduced fees are provided on a very limited basis, and are not based on licensee income.

Table 2. Fee Scaling Practices for Selected California Licensing Boards

Licensing Board	Reduced Licensing Fees
Medical Board of California	<ul style="list-style-type: none"> • Fees waived for active duty military • 50% reduction for postdoctoral program participants
Dental Board of California	Fees reduced by 50% for the following: <ul style="list-style-type: none"> • Retired, providing low cost services only • Disabled, still practicing
Board of Registered Nursing	Fees vary by license type

INCOME LIMIT FOR FEE SCALING ELIGIBILITY

At the March meeting, the Board rejected a proposal to revise the income limit for fee scaling based on a Consumer Price Index (CPI) adjustment to the \$40,000 income limit established in 1977, since no clear rationale was identified for how that limit was initially set. The Board directed staff to propose a new income limit based on a moderate income level, and to consider whether it was practicable to base eligibility on household income rather than individual income.

Table 3 provides median household income and average household size, based on the most recent information available from the Census Bureau’s American Community Survey (ACS) for selected metropolitan areas, along with middle class income ranges calculated using the Pew Research Center’s definition of middle class households as those with income between two-thirds and double the median household income. While there is no official definition of middle class, Pew’s analysis is widely cited as a standard definition of middle class households.

Table 3. 2017 Average Household Size, Median Income,² and Middle Class Income Range

Metropolitan Area	Average Household Size	Median Household Income ³	Middle Class Income Range ⁴
Statewide	2.96	\$69,169	\$46,113 - \$138,338
San Jose-Sunnyvale-Santa Clara (Highest median income)	2.99	\$105,809	\$70,539 - \$211,618
Los Angeles-Long Beach-Anaheim (Highest number of households)	3.02	\$65,331	\$43,554 - \$130,662
San Francisco-Oakland-Hayward (Second highest number of households and second highest median income)	2.71	\$92,714	\$61,809 – \$185,428

² United States Census Bureau, *American Community Survey, 2013-2017*.

³ ACS median income does not include a regional cost of living adjustment.

⁴ Middle class income range is calculated based on the Pew Research Center’s definition: two-thirds to double median household income.

Since ACS data does not provide information about median income for households of varying sizes, this data would be useful only if the income limit for scaling were set based on average household size in California. As explained in footnote 4, ACS does not provide information about middle class income; these ranges are calculated based on the definition of middle class households used by the Pew Research Center.

The Pew Research Center provides a more nuanced analysis of middle-class household income, adjusting for both household size and cost of living in each metropolitan area. Table 4 provides the Pew Research Center's middle class income ranges for the metropolitan areas included in Table 3.

Table 4. Middle Class Income Range Based on Household Size⁵

Household Size	1	2	3	4	5
Middle Class Income Range					
Statewide	\$29,851 - \$89,552	\$42,215 - \$126,646	\$51,703 - \$155,109	\$59,702 - \$179,105	\$66,748 - \$200,245
San Jose- Sunnyvale- Santa Clara	\$33,165 - \$99,494	\$46,902 - \$140,706	\$57,443 - \$172,329	\$66,329 - \$198,988	\$74,158 - \$222,475
Los Angeles-Long Beach-Anaheim	\$30,712 - 92,136	\$43,433 - \$130,300	\$53,195 - \$159,584	\$61,424 - \$184,271	\$68,674 - \$206,022
San Francisco- Oakland-Hayward	\$32,538 - \$97,615	\$46,016 - \$138,049	\$56,358 - \$169,075	\$65,077 - \$195,231	\$72,758 - \$218,275

STAFF RECOMMENDATIONS

- **Individual Income**
For ease of administration, staff recommends adoption of an income limit for fee scaling based on *individual income* rather than household income.
- **Middle Class Income**
Staff recommends providing fee scaling for attorneys whose income is at or below the statewide middle class income range. If this recommendation is adopted, *attorneys whose individual income falls below \$90,000 would qualify for fee scaling.*
- **Annual Adjustment**
Staff recommends that the income limit(s) for fee scaling be adjusted annually based on the Consumer Price Index.

⁵ Pew Research Center analysis of 2016 American Community Survey.

ALTERNATIVE OPTIONS

- **Household Income**
If the Board adopts fee scaling limits based on household income, staff recommends using the top of the middle class income range for a household of three, which represents the average household size in California, as shown in Table 3. These ranges could be used in combination, as follows:
- Individual income below \$90,000 *and* household income below \$155,000; or
- Individual income below \$90,000 *or* household income below \$155,000.

As discussed above, staff recommends against using household income to determine fee scaling eligibility; while average household size would provide a simple basis for setting household income at one level, this level would advantage some households and disadvantage others. For example, a household of two would be entitled to the same fee reduction as a household of five with the same total income.

- **Moderate Income**
Staff reviewed income limits used by the California Department of Housing and Community Development (HCD) to determine eligibility for HCD programs. HCD calculates moderate household income at 120 percent of median income by county. Table 5 provides HCD's moderate income levels for the counties that correspond with the metropolitan areas included in Table 3 and Table 4.

Table 5. HCD Moderate Household Income

Household Size	1	2	3	4	5
Santa Clara	\$105,200	\$120,200	\$135,250	\$150,250	\$162,250
Los Angeles	\$58,200	\$66,500	\$74,850	\$83,150	\$89,800
Alameda	\$87,700	\$100,250	\$112,750	\$125,300	\$135,300

Since HCD does not provide income levels on a statewide basis, and this methodology is designed to determine *moderate* income only for housing-related programs, staff recommends using the middle class household ranges identified by the Pew Research Center.

EXPANDED ELIGIBILITY FOR SCALING

Non-Profit Employment: State Bar Rule 2.15 (B) provides for a 25 percent reduction of licensing fees for attorneys employed by IOLTA-funded legal services programs. Non-profit legal services providers that do not qualify for IOLTA funding have requested that the State Bar consider offering reduced fees for attorneys employed by their organizations. If the Board determines that expansion of reduced fees is appropriate, consideration should be given as to whether it would be offered to the following organizations :

- All non-profits organizations;
- 501(c)(3) non-profit organizations;
- Non-profit organizations that provide legal services; and/or
- Non-profit organizations that provide direct legal services to clients.

If reduced fees were available only to non-profit organizations that provide direct legal services to clients, consideration should be given as to which attorneys employed by the organization would qualify. Reduced fees could be offered to any of the following categories:

- Attorneys providing direct legal services to clients;
- Attorneys who supervise others who provide direct legal services to clients; and/or
- All attorneys employed by the organization.

Military Status: As shown in Table 1, above, nine states reduce or waive licensing fees for attorneys on active military duty. The Board may consider whether to extend fee scaling to California attorneys serving in the military, their spouses practicing law in California, both, or neither.

SCALING METHODOLOGY OPTIONS FOR PROPOSED FEE INCREASE

As discussed in Item 702 on today's agenda, the report issued by the State Auditor on April 30th recommended a \$71 ongoing increase to the licensing fee.⁶ The following tables present scaling options, based on the recommendations identified above, for both the State Bar identified funding needs and the State Auditor's recommended ongoing and one-time fee increases.

Current Scaling Methodology

Table 6 shows the impact of each fee increase to active licensees across the three current income-based attorney populations, assuming the same relative increase for licensees at all income levels. Table 6 is provided for comparison purposes only; staff does not recommend using this methodology.

Table 6. Impact of Proposed Fee Increase Based on Current Fee Scaling Methodology

Income	Scaling	2019 Fee	Proposed 2020 Fee	Increase	Percentage Increase
\$100 increase (State Bar's Identified Funding Need)					
Under \$20,000 (Household)	50%	\$166.50	\$216.50	\$50	30%
Under \$40,000	25%	\$249.75	\$324.75	\$75	30%
Above \$40,000	0%	\$333.00	\$433.00	\$100	30%
\$71 increase (Auditor's Identified Funding Need)					
Under \$20,000 (Household)	50%	\$166.50	\$202.00	\$35.50	21%
Under \$40,000	25%	\$249.75	\$303.00	\$53.25	21%
Above \$40,000	0%	\$333.00	\$404.00	\$71.00	21%

Proposed Scaling Methodology

Staff proposes a new methodology for scaling that will meet the identified funding needs without increasing fees for attorneys who are identified as eligible for fee scaling.

⁶ California State Auditor. *Report 2018-30, The State Bar of California: It Should Balance Fee Increases With Other Actions to Raise Revenue and Decrease Costs*. April 2019. <https://www.bsa.ca.gov/pdfs/reports/l2019-3.pdf>. This report also recommended a one-time assessment of \$41. If the Legislature authorizes a one-time assessment, the scaling methodology adopted by the Board would apply to this amount, as well.

The figures provided in Table 7 reflect no increase over 2019 fee levels for licensees in the following groups:

1. Household income under \$20,000;
2. Individual income under \$40,000/employed by IOLTA-funded program; and
3. Individual income between \$40,000 and \$89,999.

The following licensees are also included in Table 7, for consideration as discussed above:

1. Employed by non-profit 501(c)(3) organizations that provide legal services;⁷ and
2. Active duty military service and/or their spouses.⁸

Approximately 4.4 percent of attorneys surveyed in 2017 reported working in a non-profit organization,⁹ and 17.4 percent reported annual income between \$40,000 and \$89,999.¹⁰ Table 7 shows the impact of each fee increase on active licensees for each category eligible for scaling under this model. By not increasing the fee for those under the expanded income limit and employment categories, in order to be revenue neutral, the increase to the fee for those above the income limit ranges from 29 to 40 percent.

Table 7. Impact of Various Fee Increases on Proposed Fee Scaling Methodology

Income/Employment	Scaling	2019 Fee	Proposed 2020 Fee	Increase	Percentage Increase
\$100 base increase (State Bar's Identified Funding Need)					
Under \$20,000 (Household)	64%	\$166.50	\$166.50	\$0	0%
Under \$40,000 and IOLTA Program	47%	\$249.75	\$249.75	\$0	0%
Non-Profit Legal Services and Active Military/Spouses	29%	\$333.00	\$333.00	\$0	0%
\$40,000 and \$89,999	29%	\$333.00	\$333.00	\$0	0%
\$90,000 and above	0%	\$333.00	\$467.00	\$134	40%
\$71 base increase (Auditor's Identified Funding Need)					
Under \$20,000 (Household)	61%	\$166.50	\$166.50	\$0	0%
Under \$40,000 and IOLTA Program	42%	\$249.75	\$249.75	\$0	0%
Non-Profit Legal Services and Active Military/Spouses	22%	\$333.00	\$333.00	\$0	0%
\$40,000 and \$89,999	22%	\$333.00	\$333.00	\$0	0%
\$90,000 and above	0%	\$333.00	\$428.00	\$95	29%

⁷ As discussed above, this provision would expand beyond the scaling that is currently limited to IOLTA-funded legal services providers. A determination regarding the type of non-profit that would be eligible for scaling would need to be made.

⁸ Information about active military status is not available; it is anticipated that a very small number of licensees would fall into this category.

⁹ Data from the 2017 survey of all licensed attorneys was used, since that survey included income reported by respondents. More recent demographic data captured from the 2019 licensing fee questionnaire reflected the same rate of non-profit employment.

¹⁰ This figure does not include those who reported working at non-profit organizations and would therefore eligible for scaling based on employment.

Income To Be Included

During the March meeting, Board members inquired whether tax-sheltered income would be included in an audit to determine eligibility for scaling. Statutory requirements (Bus. & Prof. Code §6141.1) provide for presumptive qualification for fee scaling for attorneys whose “gross annual income from all sources” falls below \$40,000.

Subsequent to the March meeting State Bar staff sought technical assistance from the Taxation Section of the California Lawyers Association. The tax attorney who assisted staff in developing the present recommendation suggested using line 6 on the Form 1040, which includes total income, rather than taxable or adjusted income, to determine gross annual income for the purposes of eligibility for fee scaling. The following types of income, which are typical for attorneys in solo and small practices, are included on line 6 of the Form 1040:

- Wage income, reported on Form W-2;
- Dividend and investment income, reported on Form 1099-DIV;
- Profit from business income, reported on Schedule C;
- Rental income from an LLCs, reported on Form K-1; and
- Interest income, reported on Form 1099-INT.

Deferred income, such as contributions to 401k or IRA plans, are not reported on a Form 1040. This income has low limits, and may reasonably be excluded, as the attorney may not draw on that income until retirement age. If the attorney begins drawing on deferred income, it is reported on a Form 1099-R, and the income appears on the Form 1040. The tax attorney consulted by the State Bar concluded that, in order for income to escape inclusion by the State Bar, the individual would also have to shelter or hide income from the IRS, and would be guilty of tax evasion.

Scaling Administration

State Bar Rule 2.15(C) provides that attorneys who pay reduced fees are subject to audit, and upon request must provide documentation of their income. Random audits of scaling requests have been conducted every few years; the most recent audit, conducted in 2012, found that approximately five percent of attorneys who scaled their licensing fees did not qualify for scaling. Attorneys found not to qualify are required to pay the full licensing fee plus the applicable late payment penalty. Beginning with the 2019 licensing fee cycle, the Office of Finance will expand the scope and frequency of scaling audits.

FISCAL/PERSONNEL IMPACT

None

RULE AMENDMENTS

None

BOARD BOOK AMENDMENTS

None

STRATEGIC PLAN GOALS & OBJECTIVES

Goal: None - core business operations

RECOMMENDATIONS

It is recommended that the Board of Trustees approve the following resolution:

RESOLVED, that the Board of Trustees hereby authorizes staff to incorporate the approved scaling model into the fee increase methodology and related advocacy for the fee increase request to the Legislature.

ATTACHMENT(S) LIST

None