



STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

<p>ATTORNEY GENERAL OPINION</p> <p>by</p> <p>TERRY GODDARD ATTORNEY GENERAL</p> <p>September 1, 2009</p>	<p>No. I09-005 (R09-025)</p> <p>Re: The Arizona Bar Foundation's Beneficial Interest in and Exclusive Right to Interest Earned on Trust Accounts in IOLTA Program under Arizona Supreme Court Rule 43</p>
--	---

To: David K. Byers
Administrative Director of the Courts

Question Presented

You have asked whether, under Arizona law, the Arizona Foundation for Legal Services and Education ("Arizona Bar Foundation") will own the entire beneficial interest in and will have exclusive right to the interest income earned on trust accounts required to be established by attorneys pursuant to the provisions of Rules of the Supreme Court of Arizona, Rule 43.

Summary Answer

Yes. The Arizona Bar Foundation will own the entire beneficial interest in and will have the exclusive right to all interest income, minus a reasonable service charge or fee, earned on trust accounts to be established by attorneys in conformance with Arizona Supreme Court Rule 43.

Analysis

The Arizona Supreme Court has established an Interest on Lawyers Trust Accounts (IOLTA) program under Rule 43, Arizona Rules of the Supreme Court.¹ Pursuant to Rule 43, a lawyer must place funds belonging to a client or third person in connection with representation into one or more trust accounts that are labeled as such. Ariz. R. Sup. Ct. 43(a). These trust accounts must be interest-bearing accounts located at regulated financial institutions on which withdrawals or transfers can be made on demand. Rule 43(f)(1).² In addition, Rule 43(f)(2) provides that

[a] lawyer or law firm receiving client funds shall maintain a pooled interest-bearing or dividend-earning trust account for deposit of client funds unless the funds are expected to earn net income for the client in excess of the costs incurred to secure such income. *The interest or dividends accruing on this account, net of any reasonable service or other charges or fees imposed by the financial institution or investment company in connection with the account, shall be paid by the financial institution or investment company to the Arizona Foundation for Legal Services and Education, and shall be used solely for the following purposes: to pay the actual administrative costs of this interest or earnings on lawyers' trust accounts (IOLTA) program; to fund programs designed to assist in the delivery of legal services to the poor; to support law-related education programs designed to teach young people, educators and other adults about the law, the legal process and the legal system; to fund studies or programs designed to improve the administration of justice; and to maintain a reasonable reserve therefor.*

(Emphasis added.) Rule 43(f)(5) also compels lawyers to direct the bank or investment company at which the trust accounts are located to do the following:

- A. To remit interest or dividends, net of any reasonable service or other charges or fees imposed by the institution or company in connection with the account, as computed in accordance with the institution's or company's standard accounting practice, at least quarterly, to the Arizona Foundation for Legal Services and Education, such institution or company

¹ In 2003, the United States Supreme Court held that the placement of client funds into IOLTAs and the transfer of the interest income generated to non-profit organizations designed to provide education and legal services to the poor did not violate the Fifth Amendment. *Brown v. Legal Found. of Wash.*, 538 U.S. 216 (2003).

² Rule 43(f)(1)(B) also allows a lawyer the alternative of utilizing under certain circumstances "United States Treasury obligations and repurchase agreements fully collateralized by such obligations."

being permitted to remit the interest and dividends on all such accounts to the Arizona Foundation for Legal Services and Education in one payment; and

- B. To transmit with each remittance to the Arizona Foundation for Legal Services and Education a statement showing the name of the lawyer or law firm on whose account the remittance is sent, the rate of interest applied or the dividends earned, and any service or other charges and fees imposed, with a copy of such statement to be transmitted to the lawyer or law firm. The manner of statement shall be determined by the Foundation.

Financial institutions that participate in the IOLTA program must be approved by the Arizona State Bar and the Bar Foundation, which create the rules governing the approval and the termination of approved status for such institutions. Ariz. R. Sup. Ct. 43(g). Those organizations maintain and annually publish a list of approved participating financial institutions. *Id.* A lawyer who is an Arizona State Bar member may be suspended for failure to comply with Rule 43. Ariz. R. Sup. Ct. 43(h).

Because Rule 43 requires that the client funds be placed in accounts that are interest-bearing and from which the funds may be withdrawn on demand, the IOLTA program is feasible only if client funds placed in trust accounts established by attorneys pursuant to Rule 43 qualify under 12 U.S.C. § 1832(a)(2) for deposit in negotiable order of withdrawal accounts, commonly referred to as "NOW" or "Super NOW" accounts, and established in 1980 by Congress' passage of the Consumer Checking Account Equity Act, Pub. L. No. 96-221, 94 Stat. 132, 145-150.³ This legislation authorized banks and financial institutions to offer NOW accounts, which, unlike "traditional" checking accounts, allow the earning of interest income on funds subject to withdrawal by negotiable instruments. However, Congress restricted the use of NOW and Super

³ Before the passage of this law in 1980, attorneys usually held such client funds in noninterest-bearing, pooled accounts; these accounts were noninterest bearing because federal law prohibited the payment of interest on checking accounts. See 12 U.S.C. §§ 371a, 1464(b)(1)(B), 1828(g); *Phillips v. Wash. Legal Found.*, 524 U.S. 156, 160 (1998).

NOW accounts. Section 303 of the Consumer Checking Account Equity Act of 1980, 12 U.S.C.

§ 1832, provides in pertinent part as follows:

(a) Authority of depository institution; applicability

(1) Notwithstanding any other provision of law but subject to paragraph (2), a depository institution is authorized to permit the owner of a deposit or account on which interest or dividends are paid to make withdrawals by negotiable or transferable instruments for the purpose of making transfers to third parties.

(2) Paragraph (1) shall apply only with respect to deposits or accounts which consist solely of funds in which the entire beneficial interest is held by one or more individuals or by an organization which is operated primarily for religious, philanthropic, charitable, educational, or other similar purposes and which is not operated for profit.

Thus, a “NOW” or “SUPER NOW” account may be maintained only if the entire beneficial interest in such an account is held by an individual or individuals or a nonprofit organization as defined in the Internal Revenue Code at 26 U.S.C. § 501(c)(3).

In December 2002, the Internal Revenue Service reaffirmed the Arizona Bar Foundation’s federal income-tax exemption under section 501(c)(3) of the Internal Revenue Code. *See* Letter from John E. Ricketts, Director, TE/GE, Internal Revenue Service, to Arizona Foundation for Legal Services & Education (Dec. 13, 2002). As noted above, under Rule 43 of the Arizona Supreme Court, a lawyer must establish a trust account in a manner that assures that the interest income derived from the funds deposited pursuant to the IOLTA program will not be remitted to the attorney, a law firm, or the client. Instead, the interest must be remitted to a third party, the Arizona Bar Foundation, a section 501(c)(3) organization.

Thus, the only remaining issue is whether the Arizona Bar Foundation owns the “entire beneficial interest” in the interest income derived from such an account. While Arizona courts have not construed the term “beneficial interest” as used in this context, case law has previously defined the term as profit, benefit or advantage resulting from contract or ownership of estate as

of estate as distinct from legal ownership or control. *Christiansen v. Dep't of Soc. Sec.*, 131 P.2d 189, 191 (Wash. 1942); *see also In re Naarden Trust*, 195 Ariz. 526, 529, ¶ 11, 990 P.2d 1085, 1088 (App. 1999) (noting that, while a trustee holds legal title to the trust res, the beneficiary of a trust “gains a beneficial interest in the trust property”); Restatement (Third) of Trusts § 42, cmt. A (2003) (“[B]eneficiaries hold the beneficial interests (or ‘equitable title’) in the trust property, while the trustee (ordinarily) holds ‘bare’ legal title to the property.”). This accords with the definition of “beneficial interest” in *Black’s Law Dictionary* 142 (5th ed. 1979): “Profit, benefit, or advantage resulting from a contract, or the ownership of an estate as distinct from the legal ownership or control.”

Lawyers depositing funds into interest-bearing accounts must comply with Rule 43 by directing the financial institutions holding the deposits to remit the entire amount of interest, minus a reasonable service charge or fee, to the Arizona Bar Foundation. The result of Rule 43’s directive is that the Arizona Bar Foundation has an exclusive interest in receiving all income from any pooled interest-bearing accounts established by lawyers and law firms. Although the attorney acting on behalf of the client retains the legal interest in the funds, the Arizona Bar Foundation holds the entire beneficial interest in and will have the exclusive right to the interest earned upon such accounts.⁴

⁴ We note that several other state attorneys general have come to the same conclusion with respect to the issue of whether their states’ bar foundations own the entire beneficial interest in income interest derived from client funds deposited in lawyer trust accounts pursuant to IOLTA program requirements. *See, e.g.*, Ind. Att’y Gen. Op. No. 98-03; 63 W. Va. Att’y Gen. Op. No. 33; 1987-1988 Mich. Att’y Gen. Op. No. 6462; Mo. Att’y Gen. Op. No. 62-85.

Conclusion

Pursuant to Rule 43, Rules of the Arizona Supreme Court, the Bar Foundation will own the entire beneficial interest in and have the exclusive right to interest earned, minus a reasonable service charge or fee, on funds deposited in trust accounts in the IOLTA program.

Terry Goddard
Attorney General