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# LAW FIRM MANAGEMENT

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## There's a lot to like about the OBBBA

Now that the dust has settled from this summer's enactment of the One Big Beautiful Bill Act (OBBBA), law firm leaders have plenty to think about regarding tax planning. The good news is there's a lot to like about the OBBBA in terms of potential strategies. Just two examples are how the law boosts the qualified business income (QBI) deduction and enhances accelerated depreciation.

### QBI DEDUCTION

The QBI deduction was created in 2017 under the Tax Cuts and Jobs Act (TCJA). It generally allows businesses structured as pass-through entities to deduct up to 20% of their QBI. Such entities include popular law firm choices such as general partnerships, limited liability partnerships and limited liability companies.

Essentially, QBI is the net amount of income, gains, deductions and losses from the business. It doesn't include reasonable compensation, certain

investment items and payments to partners for services rendered.

The QBI deduction was slated to expire after 2025, but the OBBBA makes it permanent. The law also brings another critical change to the deduction that significantly benefits law firms and other so-called "specified service trades or businesses" (SSTBs). For these organizations, the amount of the QBI deduction phases out based on taxable income.

Under the TCJA, the phase-in range extends from the taxable income threshold over the next \$50,000 of taxable income for single filers and the next \$100,000 of taxable income for joint filers. For 2025, the ranges are \$197,300 to \$247,300 for single filers and \$394,600 to \$494,600 for joint filers. Once taxable income exceeds the upper limit, SSTBs aren't allowed a QBI deduction.

Beginning in 2026, the OBBBA expands the phase-in ranges. The range will be \$75,000 for single filers and \$150,000 for joint filers. Wider ranges should allow more lawyers to qualify for a QBI deduction.

And there's more good news: Although the OBBBA imposes a limit on itemized deductions for high-income taxpayers, it stipulates that taxable income for purposes of the QBI deduction is determined *without* taking that limit into account.

### ACCELERATED DEPRECIATION

As you may recall, from 2017 to 2022, the TCJA



## DEDUCT MORE BUSINESS INTEREST IN 2025 AND BEYOND

The accelerated depreciation changes under the One Big Beautiful Bill Act (OBBBA) aren't the only provisions that could make it more appealing for law firms to invest in capital expenditures. (See main article.) Starting in 2025, practices that *finance* such purchases may be able to deduct more of their business interest than in the past.

That's because the OBBBA includes a critical change to the limit on the business interest deduction. The deduction is generally limited to 30% of a taxpayer's adjusted taxable income. (ATI). For tax years 2018 through 2021, ATI was calculated without regard to allowable deductions for depreciation, amortization or depletion. In other words, it was generally calculated based on earnings before interest, taxes, depreciation and amortization (EBITDA). Beginning in 2022, ATI was based on just EBIT — with no add-back of depreciation, amortization or depletion. This reduced the allowable deduction substantially for some law firms.

The OBBBA permanently restores the pre-2022 ATI calculation beginning with the 2025 tax year. The provision isn't retroactive, however, so the EBIT-based calculation remains in place for tax years 2022 through 2024.

enabled businesses to immediately deduct 100% of the cost of eligible property purchases — generally, new and used tangible property with a “MACRS” recovery period of no more than 20 years — in the year an item was placed in service. Beginning in 2023, however, the amount of allowable bonus depreciation began dropping by 20% annually, and it was scheduled to expire altogether in 2027.

The OBBBA restores and makes permanent 100% first-year bonus depreciation for qualified property acquired and placed in service after January 19, 2025. Law firms can take advantage of the tax break by investing in items such as computer systems and software, office furniture, and qualified improvement property (generally, interior improvements to nonresidential real property).

The law also raises the Section 179 expense deduction limit to \$2.5 million and the phaseout threshold to \$4 million for 2025. Both amounts will be adjusted annually for inflation going forward.

Keep in mind, though, that depreciation-related deductions can affect other tax strategies. For example, such deductions reduce your QBI and, in turn, the amount of the QBI deduction. On the other hand, they also reduce taxable income, which could help you qualify for a partial QBI deduction that you might otherwise miss out on if you exceed the phase-in range for SSTBs. A cost-benefit analysis may be advisable to determine your best course of action.

In some cases, you might even prefer to depreciate assets over a longer recovery period if you expect to move up to a higher tax bracket in the future. Deductions are more valuable when you're subject to higher tax rates.

### AND THAT'S NOT ALL

Changes to the QBI deduction and accelerated depreciation are just a few of dozens of OBBBA provisions that could affect the tax liability of your law firm and its partners. Your CPA can help you leverage the law's impact to minimize your tax bill. •

# What legal practices can expect from the M&A experience

The legal industry is no stranger to mergers and acquisitions (M&A) activity. In fact, as of this writing, 2025 is shaping up to be a robust year in this regard. If your practice might someday seek to merge with or acquire a target firm, it's important to set realistic expectations. Here are some of the actions you'll likely need to take.

## MONEY MATTERS

Thorough M&A due diligence is essential, and it typically starts with examining the target firm's finances. First, review its financial statements going back at least two years.

Consider both on- and off-balance sheet items — including outstanding liens, unfunded retirement plan obligations, unpaid tax liabilities, deferred compensation, pending litigation and other contingent liabilities. You'll also want to scrutinize the firm's general ledgers, accounts receivable and payable, notes payable, fixed assets, depreciation schedules, and nonrecurring income and expenses.

In addition, ask the target firm to provide projections on partner buyout costs, impending retirements over the next five to 10 years, client

retention and billing rates. If necessary, request additional information on the assumptions and data used to create the projections so you can determine whether they're reasonable.

*How much of a target firm's revenue is attributable to a few top payors?*

Look at several years of federal and state income tax returns, too. Sales and use taxes, as well as commercial rent taxes, may also warrant examination.

## OPERATIONAL CONCERNS

Naturally, you're going to need to look beyond the target firm's financial reporting to spot potential problems. For example, research its billing practices. What payment methods does the firm accept? What are its collection policies and realization rates? Determine whether the firm routinely allows clients to delay paying

invoices or if it gives discounts for paying off outstanding balances, thus rewarding clients for late payments.

Another concern is adverse "client concentration." That is, how much of the firm's revenue is attributable to a few top payors? Quantify the risk of losing major clients following an M&A deal and, thereby, also losing a substantial amount of income from those parties.

Additionally, investigate the target firm's history of malpractice claims. Defense, damage and settlement costs — and their



effect on insurance premiums — are important. You also need to know whether you'll be taking on any attorneys with lengthy claims histories.

### ENTITY CHOICE

Failing to address how the newly constituted practice will be structured can lead to unpleasant tax surprises following a merger or acquisition. For example, if both firms are partnerships, some or all partners might see accelerated taxable income on their individual tax returns because of the “pass-through” nature of these entities.

But say a partnership merges with a firm that's a professional corporation, which is taxed at the entity level. If a new partnership is then formed, the corporation would have to liquidate. That could have adverse tax consequences, too.

### STAFFING AND CULTURE

Adding talent is generally one of the goals when one law firm merges with or acquires another. So, you'll need to know precisely what the target firm's partners and associates bring to the table — both good and bad.

Who are the rainmakers? Who might leave soon? Will you need to offer incentives to retain the firm's desirable attorneys (and, in turn, their clients)? Which practice areas are the strongest and weakest? What's the firm's compensation structure? What are its demographics?

Look at support staff, too. Create an organizational chart showing everyone's job titles and level of authority. Compile a detailed glossary of job descriptions, along with salary amounts and histories.

Finally, don't overlook a target firm's culture. You need to get a sense of the office environment, how its people interact and, most important, whether its culture would conflict with yours. Raise this issue with your contacts at the target firm. Consider interviewing current or former attorneys or other employees, if possible.

### ODDS OF SUCCESS

As you can see, pursuing an M&A deal with another law firm is quite an involved undertaking. To increase your odds of success, exercise patience and involve objective professional advisors. •

## Stay on the safe side with strong trust account compliance

**In some ways, running a law firm is just like operating any other type of business. You hire employees, stock up on office supplies and hope to keep more than you spend. But in other ways, it's not.**

One distinctive aspect of running a legal practice is trust account compliance. The rules for maintaining these bank accounts are strict. And the consequences for violations — whether inadvertent or otherwise — can be severe.

### WHY IT MATTERS

As you're no doubt aware, trust accounts hold client funds for specific purposes — such as retainer fees, settlement proceeds and escrow services. Law firms hold a fiduciary duty to separate those dollars from their own operating funds and use them only in the context of the specific legal matter with which they're associated. Generally, state bar associations, state courts and certain other regulatory bodies set forth

detailed requirements for how practices should maintain, document and reconcile the accounts.

While deliberate misuse of trust account funds can occur and is critical to prevent, the most common compliance issues stem from human error and misconceptions about the rules. Whatever their cause, errors can damage client relationships, trigger costly disciplinary actions and, in worst-case scenarios, even threaten attorneys' licenses to practice.



### 3 COMMON MISTAKES

So, what should you watch out for? Three of the most common trust account mistakes are:

**1. Commingling funds.** Mixing up the firm's own money with trust account funds can happen when, for example, an attorney or other employee deposits a trust check into the practice's operating account by mistake or to save time.

*Be sure human eyes stay engaged in overseeing your firm's trust account.*

**2. Inaccurate or incomplete recordkeeping.**

Your records must clearly show the source, purpose and balance of every client's funds at any given moment.

**3. Failing to perform timely reconciliations.**

At minimum, conduct monthly "three-way" reconciliations that ensure the bank statement, client ledger and trust ledger all match.

Whether it's one of these mistakes or something else, regulators take trust account violations seriously because they undermine public confidence in the legal profession. Penalties may range from fines and restitution to suspension or even disbarment in extreme cases. If clients

catch wind that your trust account is being mismanaged, your firm's reputation can suffer.

### PREVENTIVE MEASURES

Avoiding dire consequences from trust account violations begins with a carefully written policy that aligns with your jurisdiction's rules. Ask every attorney and staffer who handles client funds to sign an acknowledgment of the policy. And then, of course, train them on it thoroughly and monitor their performance.

If you're not already using specialized trust accounting software that integrates with your practice management system, consider doing so. Automation can help reduce human error and maintain better data consistency. However, don't overly rely on technology — be sure human eyes stay engaged in overseeing your firm's trust account.

Last, schedule regular independent reviews of your accounting procedures. An objective viewpoint can go a long way toward identifying weaknesses and spotting opportunities for improvement.

### STRONG PRACTICES

If your firm has a solid record of trust account compliance, give yourself some credit. But don't get complacent — an exceptionally busy practice, staffing fluctuations and rule changes can all cause trouble. Consult your CPA for help conducting audits and following strong accounting practices. •

# Is your law firm automated enough?

By now, many legal practices have automated at least a few of their key processes. However, as technology evolves — especially now with artificial intelligence (AI) in the picture — there may be even more opportunities to streamline operations through carefully chosen automated solutions. So, is your law firm automated enough?

## BUILDING THE CASE

The benefits of automating certain practice processes extend beyond simply freeing up time from mundane tasks. Properly implemented, automation can reduce human error by sparing administrative staff from having to manually enter data or input the same information in multiple places. It can also boost attorney satisfaction, as more time is spent on billable work that uses their expertise and knowledge.

The right automated solutions can improve the client experience, too. Your practice may be able to set up an entire engagement with the assistance of automation much more quickly than using traditional methods. And don't forget that software purchases generally qualify for newly enhanced depreciation tax breaks under the One Big Beautiful Bill Act.

## 3 SUITABLE FUNCTIONS

In most law firms, certain functions are particularly suitable for automation. Three common examples are:

**1. Client intake.** With the right software, your firm can create customized online forms for each type of engagement. Doing so enables clients to easily enter their introductory information themselves. Each form can solicit only the most necessary data, saving time and reducing the chance of mistranslation if a new client contacts the office by phone.

**2. Document drafting.** As mentioned, AI is changing the game. Users can fill out a questionnaire or enter a prompt to create a draft of a lease or letter of engagement. In a matter of seconds, AI will produce a document ready for human inspection. The technology is also capable of contract review, checking for essential provisions and comparing later drafts with earlier ones to ensure nothing has fallen through the cracks.

**3. Billing and collections.** The accounts receivable process is often subject to delays that slow cash flow — especially for solo practitioners and smaller firms. Automated billing lessens the odds of typos and miscalculations, which can occur with manual, paper-based time tracking and invoicing systems. It also provides automatic past-due notifications. Should an invoice dispute arise, an automated system creates a much more detailed, accessible audit trail.

## TARGETING SOLUTIONS

Like any technological investment, automation must be approached carefully. It's all too easy to throw away dollars on the latest bells and whistles. Work with your leadership team and professional advisors to target solutions that will enhance workflows and provide measurable value to the practice. •





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