

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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[Third Party Communication:
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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B05
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Date:
January 05, 2010

TY:

Legend

Taxpayer =
Defendants =

Legal Aid Organization 1 =

Legal Aid Organization 2 =
Law Firm =
City =
Year 1 =
Year 2 =
Year 3 =
Lawsuit =

Order =

\$x =
\$y =
\$z =
Act =
Section X of Act =

Dear _____ :

This is in response to a request for a private letter ruling dated July 23, 2009, submitted on your behalf by your authorized representatives. You (Taxpayer) have requested a ruling that an award of attorneys' fees of \$y awarded directly to Legal Aid Organization 1 and Law Firm in the Order is excludible from your gross income under the circumstances set forth below.

FACTS

In Year 1, Taxpayer was one of several named plaintiffs who brought Lawsuit against Defendants alleging that Defendants engaged in improper practices under the Act. Lawsuit was not a class action. Taxpayer was represented on a *pro bono* basis by Legal Aid Organization 1, Legal Aid Organization 2, and Law Firm. These organizations took the case to ensure that businesses like Defendants' comply with the Act.

Taxpayer entered into a Retainer Agreement with Legal Aid Organization 1. In the "Fees and Costs" section, the Retainer Agreement states that, "[Legal Aid Organization 1] will not charge [Taxpayer] a fee for its services." Law Firm joined Legal Aid Organization 1 as co-counsel and agreed to represent Taxpayer and the other plaintiffs at no charge. Legal Aid Organization 2 also represented the plaintiffs at no charge. Taxpayer did not enter into a retainer agreement or other contract for services with Legal Aid Organization 2 or Law Firm. Taxpayer has no obligation, contractual or otherwise, to pay any fees or other costs to Legal Aid Organization 1, Legal Aid Organization 2 or Law Firm.

Taxpayer and the co-plaintiffs prevailed in Lawsuit. In year 2, the court entered judgment and awarded Taxpayer \$x, the maximum recovery under the Act. Under Section X of Act, plaintiffs are entitled to recover "the costs of the action, together with reasonable attorneys' fees and costs." In Year 2, Legal Aid Organization 1 and Law Firm filed a motion for attorneys' fees and costs. In Year 3, the court issued Order, awarding \$z attorneys' fees and other costs to co-counsel, Legal Aid Organization 1 and Law Firm. The portion of the \$z attorneys' fees attributable to Taxpayer's claim was \$y.

LAW AND ANALYSIS

Taxpayer concedes that the \$x award is taxable income but contends that the award of \$y in attorneys' fees is not includible in Taxpayer's gross income under § 61 of the Internal Revenue Code ("Code").

Section 61(a) of the Code defines "gross income" as "all income from whatever source derived." The definition extends broadly to all economic gains (accessions to wealth) not otherwise specifically exempted from taxation under the Code. Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 429-430 (1955).

In the context of legal services contracts (retainers), plaintiff typically agrees to pay attorneys a fee for service. The fee may be a flat fee or a contingency fee. Under either arrangement, the plaintiff has a contractual obligation to pay the attorneys' fees. If a court awards attorneys' fees to a successful plaintiff and the plaintiff uses the recovery to pay (or offset payment of) attorneys' fees, plaintiff must include the awarded attorneys' fees in gross income under § 61(a) of the Code. See Kenseth v.

Commissioner, 114 T.C. 399 (2000), affd. 259 F.3d 881 (7th Cir. 2001); O'Brien v. Commissioner, 38 T.C. 707, 712 (1962), affd. per curiam 319 F.2d 532 (3d Cir. 1963). The rationale is that the taxpayer receives the benefit of the payment, i.e., an economic gain through debt satisfaction. When a third party makes a payment to satisfy a taxpayer's (plaintiff's) obligation to a creditor (retained attorney), the taxpayer realizes an economic gain includable in gross income, even if the third party pays the creditor directly and the taxpayer never receives the payment. Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929).

The principle of Old Colony Trust Co. applies whether the attorneys' fees are paid on a contingency-fee basis or under a fee shifting statute. Sinyard v. Commissioner, 268 F.3d 756 (9th Cir. 2001), affg. T.C. Memo. 1998-364; Vincent v. Commissioner, T.C. Memo. 2005-95 (attorneys' fees awarded pursuant to a fee shifting statute or regulation must be included in the gross income of the plaintiff where the awards are in lieu of contingency-fee.) See also, Sanford v. Commissioner, 95 T.C.M. 1618 (2008); Green v. Commissioner, T.C. Memo 2007-39.

The Supreme Court has reached the same result. In Commissioner v. Banks, 543 U.S. 426 (2005), the Court held that the portion of plaintiff's recovery from a money judgment or settlement paid to plaintiff's attorney under a contingency-fee agreement is included in the plaintiff's gross income. The Supreme Court viewed the contingency-fee agreement as an attempted anticipatory assignment of a portion of the client's income (litigation recovery) to the attorney. In its discussion the Court explained that a taxpayer cannot exclude an economic gain from gross income by assigning the gain in advance to another party. Lucas v. Earl, 281 U.S. 111 (1930); Comm'r v. Sunnen, 333 U.S. 591, 604 (1948); Helvering v. Horst, 311 U.S. 112, 116-117 (1940).

Attorneys' fees awarded to a successful litigant are generally includible in the litigant's gross income under either the anticipatory assignment of income doctrine of Banks and Lucas v. Earl or under the payment of a liability doctrine enunciated in Old Colony Trust. Under both analyses, the litigant has an obligation, by express or implied agreement, to pay attorneys fees. Taxpayer's case is distinguishable because Taxpayer had no obligation to pay attorneys' fees. In fact, Taxpayer's agreement (retainer contract) expressly provided that Legal Aid Organization 1 would not charge Taxpayer any fee for legal services. In addition, Taxpayer had no retainer contract with (and did not otherwise agree to pay any fees to) Legal Aid Organization 2 or Law Firm for their legal services. Rather, Legal Aid Organization 1 and Law Firm requested attorneys' fees directly under the provisions of Section X of Act; they did not seek attorneys' fees on behalf of Taxpayer or in lieu of Taxpayer's contingency fee obligation.

We therefore conclude that the award of \$y in attorneys' fees is not includible in Taxpayer's gross income under § 61 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

William A. Jackson
Branch Chief, Branch 5
Office of Chief Counsel
(Income Tax & Accounting)