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Dear :

This is in response to a request for a private letter ruling dated January 8, 2015, submitted on your behalf by your authorized representative. You have requested a ruling that an award of attorneys' fees and costs paid by Defendants in settlement of Lawsuit is not includible in your gross income under the circumstances described below.

FACTS

You engaged the services of two legal aid organizations to challenge under Act 1 and Act 2 certain policies adopted by State. Act 1 forbids organizations receiving Federal financial assistance from excluding or denying certain individuals an equal opportunity to receive program benefits and services. Act 1 contains the following fee-shifting provision:

In any action or proceeding to enforce or charge a violation of a provision of this subchapter, the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs.

Extending the prohibitions of Act 1, Act 2 prohibits discrimination by all public entities, regardless whether they receive federal funding. Similar to the fee-shifting provision of Act 1, Act 2 provides:

In any action or administrative proceeding commenced pursuant to this chapter, the court or agency, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee, including litigation expenses, and costs, and the United States shall be liable for the foregoing the same as a private individual.

The retainer agreement with Legal Organization 1 provided that it would not charge you for its legal work. Legal Aid Organization 1 and Legal Aid Organization 2 executed a Request for Approval to Co-Counsel. The organizations reasoned that co-counseling would expand the amount of legal resources available to you; the Legal Aid Organization 2 attorney possessed special experience and expertise in the subject matter to be litigated; and you were located in the area served by Legal Aid Organization 2 and would otherwise be unrepresented. You were not a signatory to this agreement. Subsequently, you executed a retainer agreement with Legal Aid Organization 2, which provided that you would not have to pay for your lawyer or paralegal.

The Lawsuit successfully sought injunctive relief against Defendants in Court under Act 1 and Act 2. Thereafter in Year 2, you and Defendants executed a settlement

agreement requiring Defendants, *inter alia*, to pay attorneys' fees and costs of \$x (\$z to Legal Aid Organization 2 and \$y to Legal Aid Organization 1.)

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code defines "gross income" as "all income from whatever source derived." The Supreme Court broadly construed this definition "in recognition of the intention of Congress to tax all gains except those specifically exempted" from taxation by another section of the Code. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429-30 (1955).

Generally, a taxpayer must include in gross income under § 61 (a) of the Code fees and costs recovered as a prevailing plaintiff. See, e.g., *Sinyard v. Commissioner*, 268 F.3d 756 (9th Cir. 2001), *aff'g* T.C. Memo. 1998-364. The rationale for this holding is grounded in *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929), where the Court ruled that a taxpayer derives income when a third party discharges the taxpayer's legal obligation.

In *Commissioner v. Banks*, 543 U.S. 426 (2005), the Court held that the portion of a plaintiff's recovery from a money judgment or settlement paid to the plaintiff's attorney under a contingency-fee arrangement is included in the plaintiff's gross income. The Supreme Court viewed the contingency-fee agreement as an attempted anticipatory assignment of income of a portion of the client's income (litigation recovery) to the attorney. 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).

Attorneys' fees awarded to a successful litigant are generally includible in a litigant's gross income under either the anticipatory assignment of income doctrine of *Banks* and *Earl* or the payment of a liability doctrine enunciated in *Old Colony Trust*. However, your situation is different because you had no obligation to pay attorneys' fees.

CONCLUSION

Based on the information submitted and representations made, we conclude that the \$y paid to Legal Aid Organization 1 and the \$z paid to Legal Aid Organization 2 is not includible your gross income under § 61.

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

Except as expressly provided herein, we do not express or imply an opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 ruling contained in this letter is based on 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 a ruling, it is subject to verification on examination.

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

Sincerely,

Michael J. Montemurro
Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: