Ayalon Eliach
National Association of Consumer Advocates
1215 17th Street NW, 5th Floor
Washington, DC 20036

(Insert the date of request)

Internal Revenue Service
Attn: CC:PA:LPD:DRU, Room 5336
1111 Constitution Ave., NW
Washington, DC 20224

Dear Sir or Madam:

[redacted] ("[redacted]" or "Taxpayer") requests a ruling under Section 61 of the Internal Revenue Code[1] on the proper treatment of amounts paid with respect to a transferred statutory claim for attorneys' fees and costs.

A. STATEMENT OF FACTS

1. Taxpayer Information

(a) Name: [redacted]

Address: [redacted]

SSN: [redacted]

(b) [redacted] has an annual accounting period ending on December 31. She files Federal income tax returns on the basis of the cash method of accounting.

2. Description of Taxpayer's Business Operations

[redacted] is a [redacted].

[1] Unless otherwise indicated, all Section references in this memorandum are to the Internal Revenue Code of 1986, as amended.

3. Facts

[redacted] is a resident of [redacted], and a mother of [redacted] children. In [redacted], she was subjected to improper credit reporting practices by a potential employer ("Defendant"), when she applied for a job as a [redacted].

On [redacted], [redacted] signed a representation agreement (the "Original Agreement", Exhibit A) with [redacted] ("Attorney"), a [redacted] law firm, to represent her in pursuing her claims against Defendant. The fee section in the Original Agreement stated that [redacted]'s case would be litigated under a fee-shifting statute and that [redacted] agreed to assign any attorneys' fees and costs to Attorney.

In [redacted], Attorney filed suit on behalf of [redacted], alleging violation of the Fair Credit Reporting Act, 15 U.S.C. §§ 1681, *et seq.* ("FCRA"), a fee-shifting statute. [redacted] and Attorney alleged that Defendant violated the FCRA by failing to provide [redacted] with copies of her background report and consumer report. A copy of the complaint is attached as Exhibit B.

In [redacted], Attorney presented [redacted] with a modified representation agreement (the "Current Agreement", Exhibit C), which [redacted] signed on [redacted] (a copy of the [redacted] confirming the date on which the agreement was signed is attached as Exhibit D). The fee section of the Current Agreement states that [redacted] assigns her statutory claim for fees and costs to Attorney. The Current Agreement states that the effectiveness of this assignment is contingent upon the Internal Revenue Service (the "Service") ruling favorably on this letter ruling request. Once effective, the Current Agreement replaces the Original Agreement retroactively and *in toto*. According to the terms of the Current Agreement, [redacted] has no obligation to pay Attorney any amounts.

[redacted] has no obligation to pay Attorney any other amounts.

As of the time that [redacted] signed the Current Agreement, she had neither settled her suit with Defendant nor had the timing of the appeals process expired. As of the time that this letter ruling request is submitted, [redacted] has neither settled her suit with Defendant nor has the timing or the appeals process expired.

[redacted] qualifies for the Earned Income Tax Credit ("EIC"). She has applied for and received the EIC in the past, and she expects to do so again for 2015.

B. RULING REQUESTED

Taxpayer respectfully requests the following ruling:

Any amounts paid in respect of the statutory claim for attorneys' fees and costs that Taxpayer has transferred will not be includible in Taxpayer's gross income. Additionally, Taxpayer will not realize any income from the assignment.

C-D. STATEMENT OF LAW AND ANALYSIS

In general, gross income of a taxpayer includes all income from whatever source derived unless otherwise provided. Section 61(a).

In general, under the anticipatory assignment of income doctrine, if a taxpayer transfers the right to receive income before actually receiving such income, such income is still includible in the taxpayer's income if, based on the realities and substance of the events, the receipt of the income is practically certain to occur (i.e., whether the right basically has become a fixed right) at the time of transfer. *Ferguson* v. *Commissioner*, 174 F.3d 997 (9th Cir. 1999); *Jones* v. *United States*, 531 F.2d 1343, 1346 (6th Cir. 1976); *Kinsey* v. *Commissioner*, 477 F.2d 1058, 1063 (2d Cir. 1973); *Hudspeth* v. *United States*, 471 F.2d 275, 280 (8th Cir. 1972); *Estate of Applestein* v. *Commissioner*, 80 T.C. 331 (1983); *Lucas* v. *Earl*, 281 U.S. 111 (1930). However, the mere anticipation or expectation of the receipt of income is insufficient to conclude that a fixed right to income exists. *S.C. Johnson & Son, Inc.* v. *Commissioner*, 63 T.C. 778, 787-88 (1975).

With respect to the assignment of claims in litigation, the courts have held that anticipatory assignment of income principles require the transferor to include the proceeds of the claim in gross income where recovery on the transferred claim is certain at the time of transfer, but not where recovery on such claim is doubtful or contingent at the time of transfer. *Doyle* v. *Commissioner*, 147 F.2d 769 (4th Cir. 1945) (holding that assignor of portion of legal claim had to include proceeds of entire claim in gross income because recovery "had already been rendered certain by the judgment of the Court of Claims and denial of certiorari by the Supreme Court" at the time of transfer); *Cold Metal Process Co.* v. *Commissioner*, 247 F.2d 864 (6th Cir. 1957), *rev'g* 25 T.C. 1333 (1956) (holding that assignor of legal claim did not have to include proceeds of such claim in gross income because, at the time of transfer, the claim was merely a "contingent right to income … payable if at all, at some indefinite time in the future in an indeterminate amount, with respect to which the assignor had no voice or control whatsoever …"); *see also Jones* v. *Commissioner*, 306 F.2d 292 (5th Cir. 1962) and *Schulze* v. *Commissioner*, T.C.M. 1983-263.

Although not binding precedent, the Service has noted in a Private Letter Ruling that "in general, a transferor who makes an effective transfer of a claim in litigation to a third person before the time of the expiration of appeals in the case is not required to include the proceeds of the judgment in income under the assignment of income doctrine because such claims are contingent and doubtful in nature." P.L.R. 201232024 (Aug. 10, 2012). Based on this reasoning, the Service has ruled that proceeds, including attorneys' fees, on a claim that had been transferred before settlement and the conclusion of the appeals process were not includible in the transferor's income. *Id*.

Like the taxpayer in P.L.R. 201232024, [redacted] has transferred a legal claim to a third person before settlement of her case or expiration of the appeals process. Therefore, any amounts recovered with respect to the claim for attorneys' fees and costs should not be includible in Taxpayer's gross income.

Although not binding precedent, the Government agreed explicitly with this conclusion in one of the briefs it submitted to the Supreme Court in *Commissioner* v. *Banks*, 543 U.S. 426 (2005). It wrote: "This Court indicated in *Jeff D.*, however, that a prevailing plaintiff may be free to assign his statutory claim for attorney's fees to his attorney, *see* 475 U.S. at 730-731 (noting Congress "did not prevent the party from waiving this eligibility [for attorney's fees] anymore than it legislated against assignment of this right to an attorney"), and such assignments are not uncommon…. If such an assignment is viewed as a transfer of the entirety of the attorney's fee claim to the lawyer, such that the prevailing party retains no meaningful interest in or control over the claim, then it may be possible to view any recovery on that claim as income only to the lawyer." Reply Brief for Petitioner at 19-20, *Banks* (Nos. 03892 and 03907).

As in the hypothetical assignment discussed in the Government's brief in *Banks*, [redacted]'s assignment is a transfer of the entirety of the attorneys' fee claim to Attorney, such that she retains no meaningful interest in or control over the claim. In *Zeisler* v. *Neese*, 24 F.3d 1000 (7th Cir. 1994), the Seventh Circuit noted that if a plaintiff were to assign "his statutory right to attorney's fees to the lawyer. Then the lawyer can enforce the right without the participation of his client…." *Id.* at 1002. Additionally, the Seventh Circuit noted that after such an assignment "the entitlement to attorney's fees is not the plaintiff's to waive." *Id.* The plaintiff's lawyer's ability to enforce the claim without the participation of the plaintiff coupled with the plaintiff's inability to waive the attorney's entitlement to statutory fees demonstrate that the plaintiff retains no meaningful interest in or control over the claim. [redacted]'s assignment makes such a transfer and, therefore, she no longer retains any meaningful interest in or control over the statutory claim for fees. Accordingly, Attorney should be the only taxpayer required to include in gross income any amounts paid with respect to such claim.

Under circumstances that are very different than [redacted]'s, courts have held that attorneys' fees are includible in a plaintiff's gross income. In *Banks*, the Supreme Court held that certain attorneys' fees were includible in each of the plaintiffs' gross incomes. *Banks* at 437. However, the Court's opinion explicitly left open the question of the tax treatment of fees awarded pursuant to fee-shifting statutes. *Id.* at 438-39. Furthermore, neither of the plaintiffs in *Banks* had assigned a statutory claim for attorneys' fees to a third person. Rather, they promised to pay their attorneys a share of their awards under traditional contingency-fee agreements. *Id.* at 426-37. In other words, the plaintiffs in *Banks* promised to pay their attorneys the proverbial "fruit" of their claims, whereas Taxpayer has transferred the "tree" itself: the statutory claim. *See Lucas* v. *Earl*, 281 U.S. 111 (1930); *Helvering* v. *Horst*, 311 U.S. 112 (1940); *Cold Metal Process Co.* v. *Commissioner*, 247 F.2d 864 (6th Cir. 1957) (holding that after assignment of claim in litigation, "Both the income producing property and the income therefrom were transferred in their entirety and unconditionally.... *Helvering* v. *Horst*, supra, and other similar cases are accordingly not applicable."). Taxpayer's case is distinguishable from the holding in *Banks* both because it arises under a fee-shifting statute and because, as discussed above, Taxpayer has assigned the statutory claim for attorneys' fees to her attorney, thereby alienating her dominion over the income-generating "tree."

On three occasions after *Banks*, the Tax Court has held that attorneys' fees awarded pursuant to a fee-shifting statute or regulation instead of a contingency fee agreement are includible in the gross income of the plaintiff. *See Vincent* v. *Commissioner*, 89 T.C.M. (CCH) 1119 (2005); *Green* v. *Commissioner*, 93 T.C.M. (CCH) 917 (2007), *aff'd* 2009-1 U.S. Tax Cas. (CCH) P50, 246 (9th Cir. 2009); *Sanford* v. *Commissioner*, T.C. Memo 2008-158. In *Vincent*, the taxpayer-plaintiff contracted to pay her attorney a certain percentage of the recovery, or in the event attorneys' fees were awarded by the court, an amount equal to the statutory award. 89 T.C.M. (CCH) at 1121. The Tax Court held that the award of attorneys' fees pursuant to the fee-shifting statute constituted gross income to the plaintiff because it satisfied her obligation to pay her attorney. *Id*. at 1123; *see also Sinyard* v. *Commissioner*, 268 F.3d 756, 759 (9th Cir. 2001) (plaintiffs liable for tax on fee shifting payment that relieved them of the obligation to pay a contingent fee to their attorney). Based on the general principle that the payment of a taxpayer's obligation by a third party is income to the taxpayer, *see*, *e.g.*, *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716 (1929), the statutory fee award was income to the plaintiff. *Vincent*, 89 T.C.M. (CCH) at 1123. All of these rulings are distinguishable from Taxpayer's situation because none of them involved situations in which the plaintiffs assigned the statutory claim for attorneys' fees (the "tree") to their attorneys. Furthermore, the Tax Court's reason for including the attorneys' fees in the plaintiff's gross income -- the fact that it relieved the plaintiff of a debt to the attorney -- is inapplicable to Taxpayer's case because Taxpayer does not owe her attorney any amounts.

[redacted] does not owe Attorney any amounts. The Current Agreement states that "If we do not prevail, [Attorneys] get paid nothing from [the plaintiff] or the defendant(s). If we do prevail, this assignment means that out of any settlement, verdict or judgment, we have the right to receive our fees and costs *directly from the defendant(s)*." Exhibit C, emphasis added. It also states that "Win or lose, however, *you will pay us nothing out of your pocket*." Exhibit C, emphasis added. Finally, it states that Attorney "will be entitled to receive from any legally responsible defendant(s), *not from [plaintiff]*, our fees and costs in [plaintiff's] case." Exhibit C, emphasis added. The Current Agreement's discussion of the value of the transferred claim in case of settlement is a pre-agreed-upon allocation (similar to a purchase price allocation in an asset sale) of the full settlement amount between the different portions of the settlement when such amounts are not explicitly allocated in the settlement agreement; this allocation is not an agreement by either party to pay the other any amount. Thus, the Current Agreement creates no obligation on [redacted]'s part to pay Attorney any amounts; and [redacted] has no outstanding obligation to Attorney.

The Service has repeatedly recognized that when there is no outstanding obligation to pay an attorney, and the attorney's fees are paid by a third party, they should not be included in the income of the beneficiary of the legal services. The first such situation arose when a labor union brought a claim on behalf of its members. In this case the union members were allowed to exclude any awarded attorneys' fees from their income. Rev. Rul. 80-364, 1980-2 C.B. 294 (Situation 3). The fee awards were considered reimbursements of legal expenses incurred by the union, rather than income to the individual employees. *Id*. The second situation of this type arose in connection with class action lawsuits. The Service has ruled privately several times that when there is no applicable contingency fee or retainer agreement between class members and class counsel, a payment of attorneys' fees is not income to the class members or the class representatives. *See*, *e.g.*, P.L.R. 200906012 (Feb. 6, 2009); P.L.R. 200906010 (Feb 6., 2009); P.L.R. 200748010 (November 30, 2007); P.L.R. 200518017 (May 6, 2005); see also *Eirhart* v. *Libbey-Owens-Ford Co.*, 726 F.Supp. 700 (N.D. Ill. 1989) (ordering defendant payors of attorneys' fees to not issue information returns on the payments to class members because the payments did not constitute income to the class members). The third situation of this type arose in connection with pro bono legal representation. The Service has ruled that attorneys' fees collected by a plaintiff's pro bono counsel are not includible in the plaintiff's gross income if the plaintiff had no obligation to pay the attorney any amount besides what the attorney could collect under the statutory claim for fees. P.L.R. 201015016 (Apr. 16, 2010). Like the plaintiffs in all of these cases, upon transfer of the statutory claim, Taxpayer has no outstanding obligation to pay her attorney any amount. Therefore, amounts paid by Defendant with respect to the statutory claim for attorneys' fees that has been transferred to Attorney should not be includible in Taxpayer's gross income.

The Supreme Court has also addressed the ownership of attorneys' fees outside of the tax context. In *Astrue* v. *Ratliff*, 560 U.S. 586 (2010), a plaintiff had an outstanding debt to the Government. The Government sought to collect a portion of the debt from the attorneys' fees portion of the plaintiff's recovery. The plaintiff's lawyer objected, arguing that he was entitled to the fees. The Court held that the Government had a priority interest in the fees because such fees were awarded to the plaintiff, not the lawyer. *Ratliff*'s holding is not relevant to Taxpayer's case for two primary reasons. First, unlike Taxpayer, the plaintiff in *Ratliff* did not transfer her underlying statutory claim for attorneys' fees to a third person. Second, *Ratliff* did not address the question of the taxability of such fees. Just because the Government had a right to seize the attorneys' fees does not mean that such fees were includible in Ms. Ratliff's income. The proper tax treatment of such fees would have depended on many factors, including, but not limited to, the specific contractual relationship between Ms. Ratliff and her lawyer. *See Banks* at 438-39 (suggesting that the proper tax treatment of attorneys' fees could turn on a specific "indication in *Banks'* contract with his attorney, or in the settlement agreement with the defendant, that the contingent fee paid to Banks' attorney was in lieu of statutory fees"). The Court did not address these issues as they related to income taxation. Therefore, *Ratliff* in no way contradicts the proper characterization of attorneys' fees in this case: That such fees are not includible in Taxpayer's gross income.

Including amounts paid with respect to the statutory claim for fees in Taxpayer's income would not only be an incorrect application of the law; it would also lead to a different outcome regarding both the taxation of the amounts paid and Taxpayer's eligibility for the EIC. Under the alternative, incorrect characterization, Taxpayer's only opportunity to reflect the fact that the fees are paid to Attorney rather than Taxpayer would be to deduct such fees as expenses paid for the production or collection of income under Section 212. The deduction of attorneys' fees would be a miscellaneous itemized deduction, Section 67(b), and therefore would be subject to a floor of 2% of adjusted gross income. Section 67(a). Whereas excluding attorneys' fees from gross income results in the taxpayer paying no tax on the fee award, a miscellaneous itemized deduction only reduces tax liability if total miscellaneous itemized deductions exceed 2% of adjusted gross income. In addition, the taxpayer is required to pay tax on at least 2% of the fee award, because the increase in adjusted gross income represented by the fee award also results in an increase in the miscellaneous itemized deduction floor. Furthermore, an individual subject to the alternative minimum tax is not allowed to deduct any amount of the attorneys' fees, because miscellaneous itemized deductions are not allowed in computing alternative minimum taxable income. Section 56(b)(1)(A).

Moreover, for some low income taxpayers, including Taxpayer, the inclusion of attorneys' fees in adjusted gross income, even if not taxable income, can result in substantial negative consequences because of the effect such inclusion would have on the ability to claim certain tax

credits. Taxpayer relies on her receipt of the EIC to meet her family's basic needs. The EIC is a refundable credit that is allowed by Section 32. The EIC is generally equal to a percentage (which varies based on the number of children that the taxpayer has) of the taxpayer's earned income, *see* Section 32(a)(1); but not in excess of the credit percentage of the "earned income amount" over the "phaseout percentage" (generally, a percentage less than the credit percentage) of adjusted gross income that exceeds the "phaseout amount." Section 32(a)(2). Both the earned income amount and the phaseout amounts are fixed dollar amounts that are indexed for inflation. Section 32(b)(2); Section 32(j). For 2015, these amounts are $13,870 for the earned income amount and $18,110 for the phaseout amount given Taxpayer's current filing status as a head of household with [redacted] children. Thus, a consequence of having adjusted gross income in excess of the phaseout amount would be a reduction, and perhaps elimination, of the EIC, despite the fact that Taxpayer will have received essentially no benefit from the fee award. Taxpayer will thus be left worse off for having prevailed in her lawsuit than she would have been had she never brought the case at all. Excluding the attorneys' fees from gross income is the appropriate means for avoiding this outcome, which the Supreme Court in *Banks* referred to as a "perverse result." 543 U.S. at 438.

To the best knowledge of Taxpayer and Taxpayer's representative, there is no legislation pending relevant to the tax treatment of attorneys' fees with respect to the fee-shifting statute under which Taxpayer's case arises.

E. CONCLUSION

Taxpayer has assigned her statutory legal claim for attorneys' fees and costs to a third person before settlement of her case or expiration of the appeals process. Therefore, any amounts that will be recovered with respect to the claim for attorneys' fees and costs will not be includible in Taxpayer's gross income. Additionally, Taxpayer will not realize any income from the assignment.

F. PROCEDURAL MATTERS

1. Revenue Procedure 2015–1 Statements

a. To the best knowledge of Taxpayer and Taxpayer's representative, no return of the taxpayer, a related taxpayer within the meaning of § 267 or of a member of an affiliated group of which the taxpayer is also a member within the meaning of § 1504 which would be affected by the requested letter ruling or determination letter, is currently under examination, before Appeals, or before a Federal court, or was previously under examination, before Appeals, or before a Federal court.

b. To the best knowledge of Taxpayer and Taxpayer's representative, the Service has not previously ruled on the same or similar issue for the taxpayer, a related taxpayer, or a predecessor.

c. To the best knowledge of Taxpayer and Taxpayer's representative, the taxpayer, a related taxpayer, a predecessor, or any representatives has not previously submitted a request (including an application for change in method of accounting) involving the same or similar issue but withdrew the request before a letter ruling or determination letter was issued.

d. To the best knowledge of Taxpayer and Taxpayer's representative, the taxpayer, a related taxpayer, or a predecessor has not previously submitted a request (including an application for change in method of accounting) involving the same or a similar issue that is currently pending with the Service.

e. To the best knowledge of Taxpayer and Taxpayer's representative, at the same time as this request, the taxpayer or a related taxpayer is not presently submitting another request (including an application for change in method of accounting) involving the same or similar issue to the Service.

f. The law in connection with this letter ruling request is uncertain, and the issue is not adequately addressed by relevant authorities.

g. Taxpayer's representative has not found any contrary authorities. Some authorities are distinguished in the legal analysis section of this letter.

h. The right to a conference with respect to this matter is reserved and a conference is respectfully requested in the event that you propose not to issue, or to issue adversely, any of the rulings sought.

i. Taxpayer requests that a copy of the letter ruling be faxed to the undersigned as Taxpayer's authorized representative. Taxpayer's authorized representative's address and fax number are as follows:

Ayalon Eliach
National Association of Consumer Advocates
1215 17th Street NW, 5th Floor
Washington, DC 20036
Tel: (646) 460-9592
Fax: (202) 452-0099

2. Administrative

a. The deletion statement and checklist required by Rev. Proc. 2015–1 are enclosed.

b. The required user fee is enclosed. The certification required for this reduced user fee is attached.

c. A Power of Attorney is enclosed.

d. The declaration required by Section 7.01(15) of Revenue Procedure 2015-1 is attached.

If you require further information, or wish to discuss any aspect of this letter, please telephone the undersigned at (646) 460-9592.

Respectfully submitted,

Ayalon Eliach