Issue Brief: The Attorney Fee Tax Issue post-*Eiler*

On July 14, 2026, the U.S. Tax Court issued a decision in *Eiler v. Commissioner of Internal Revenue*, finding that attorneys' fees and costs awarded to a consumer in a settlement under the Fair Credit Reporting Act (FCRA) are includible in a consumer's taxable income. The court further found that certain claims brought under the FCRA do not qualify as claims involving unlawful discrimination for the purposes of I.R.C. 62(a)(20), which provides for an above-the-line deduction for attorneys' fees and costs awarded in civil rights-related cases.

This decision is the first direct, precedential ruling on the taxability of attorneys' fees awarded in certain consumer cases. This issue brief describes the facts of the case, the court's holding, the decision's potential impact on future consumer litigants, and NACA's work to address the unfair taxation of consumers.

Facts and outcome of the underlying case

Nevada consumers James and Kathy Eiler brought separate suits against several consumer reporting agencies for alleged violations of the Fair Credit Reporting Act, specifically sections 1681e(b) (accuracy of report), 1681g (disclosures to consumers), 1681i(a) (reinvestigations of disputed information), and 1681s-2(b) (duties of furnishers of information upon notice of dispute). According to the Eilers' complaints, the CRAs reported inaccurate information on their credit reports and then failed to take the proper steps to investigate and remediate after the Eilers disputed the inaccurate information.

The Eilers entered into retainer agreements with attorneys they hired, which stated that the Eilers would receive 100% of any statutory damages awarded and 50% of any actual or punitive damages minus costs and expenses. The attorneys would receive 50% of any actual or punitive damages and 100% of attorneys' fees and costs. Additionally, the agreements stated that if the Eilers did not recover anything, then they would not pay any legal fees or costs.

Ultimately, the Eilers reached settlements in each of their cases. In total, the defendants paid $64,750 to the Eilers' attorneys, $4,900 of which was then paid to the Eilers. At the time of settlement, the payments were not allocated between statutory, actual or punitive, or attorneys' fees and costs.

The defendants issued IRS 1099 forms to the Eilers reporting the full $64,750 paid. However, the Eilers' attorneys also issued an IRS 1099 form showing $4,900, the total amount distributed to the Eilers. When filing their 2019 taxes, the Eilers only reported the $4,900 reflected in the 1099 issued by their attorneys. The IRS issued the Eilers a deficiency notice for $11,423 based on their failure to include the full $64,750 settlement lump sum as well as penalties for lack of payment.

After receiving the deficiency notice, the Eilers filed a claim in the U.S. Tax Court in 2022 to dispute any payment of additional taxes on the funds paid to their attorneys. The IRS refused to settle and waive the additional taxes and penalties as it had previously in similar cases.

<u>The Eilers' request for relief and the Court's response</u>

The Eilers asserted two primary arguments for relief in their case, both of which the Court rejected:

1) **The attorneys' fees should not be included in the Eilers' taxable income because they were negotiated under the FCRA's fee-shifting provision.** To begin, the court found that because the Eilers' settlement agreement was silent on how the damages were to be allocated, the entire amount should be presumed taxable. From there, the court found that the attorneys' fees paid in the Eilers' case were contingent fees because they met the definition of "a fee charged for a lawyer's services only if the lawsuit is successful or is favorably settled out of court." According to the court, it did not matter that the Eilers' agreement for services with their attorneys did not specify how the amount of fees would be calculated. Because of these factors, the court held that the attorneys' fees are taxable to the Eilers under the rule established in *Commissioner v. Banks*, which held that "when a litigant's recovery constitutes income, the litigant's income includes the portion of the recovery paid to the attorney as a contingent fee."

   Additionally, the court found that the fees were not awarded under the FCRA's fee-shifting provisions. Section 1681n(c) of the FCRA states that a consumer may recover reasonable attorneys' fees and costs if they bring a "successful action" and that the amount of such fees is to be "determined by the court." Because the Eilers settled out of court and the defendants disclaimed all liability, the court found that the Eilers had not brought a successful action under the FCRA and the attorneys' fees they recovered were not "determined by the court." Further, even if the fee-shifting provisions had applied, the court found that Ninth Circuit precedent in *Sinyard v. Commissioner* additionally established that attorneys' fees awarded under fee-shifting provisions are still taxable to the individual who brings the case.

2) **The Eilers argued that they were entitled to an above-the-line deduction under I.R.C. section 62(a)((20) because their case involved claims related to unlawful discrimination.** The court found that the Eilers' claims related to inaccurate credit reporting were not claims involving unlawful discrimination for the purposes of I.R.C. section 62(a)(20). I.R.C. section 62(e)(18)(i) defines "unlawful discrimination" as acts that are unlawful under a federal, state, or local statute "providing for the enforcement of

civil rights." The court looked to common meanings of "civil rights" at the time I.R.C. section 62 was enacted and observed that "civil rights" invoked concepts such as due process and equal protection. According to the court, fairness and accuracy in credit reporting do not fall under this category.

Further, the court considered the Eilers' argument that FCRA claims can fit a definition of civil rights under the right to privacy in the Fourteenth Amendment. While the court acknowledged that the FCRA could feasibly implicate a constitutional right to privacy that meets a narrower definition of "civil rights," the court found that 62(e)(18) required it to consider the specific provisions under which the Eilers brought their claims rather than the FCRA as a whole. The court then found that Eilers did not plead violations of the privacy-related provisions of the FCRA such as 1681(b) (permissible purposes of consumer reports), 1681(q) (obtaining information under false pretenses), or 1681(r) (unauthorized disclosures by officers or employees). As a result, the court concluded that the Eilers' claims did not implicate a specific civil right, so they were not eligible for an above-the-line deduction under 62(a)(20).

Future litigation

The Eilers have 90 days after the decision was entered to file an appeal in their case. Because the Eilers reside in Nevada, any appeal will be heard by the U.S. Court of Appeals for the Ninth Circuit. The Eilers and their attorneys at the Texas A&M Tax Dispute Resolution Clinic have yet to decide on whether to file an appeal.

Practical implications of the *Eiler* decision

1. **Unallocated settlement proceeds are presumed to be taxable.** The Eilers' settlement agreements were silent as to what amount was to be paid to the Eilers' attorneys and what funds were intended to go to the Eilers. Because of this, the court found that the Eilers failed to show that any amount was allocated for a nontaxable purpose so the entire settlement amount should be presumed to be taxable to the Eilers. Specifically allocated attorneys' fees and costs in settlement agreements may not be automatically presumed taxable to consumers.
2. **The court broadly construes the definition of "contingency fee."** The court found that the Eilers had a contingent fee agreement with their attorneys because their retainer agreements stated that the attorneys would not be paid if the Eilers did not receive a recovery. The court acknowledged that the agreements were silent about how the fees would be calculated, which is atypical for contingent fee agreements, but the fact that the attorneys would only recover if the Eilers did was enough to determine there was a

contingent fee arrangement. All consumer attorneys may want to consider using the bare-bones legal services retainer agreement previously approved by the IRS (in Private Letter Rulings).

3. **Attorneys' fees awarded as part of a settlement may not be considered fees awarded under the FCRA's fee-shifting provision.** According to the court, the Eilers "did not mount successful FCRA actions" because they settled and the amount of attorneys' fees was not determined by the court. In reaching settlement agreements, consumer attorneys may want to specifically delineate the distribution of the award and/or have the court approve the awarding of attorney fees.
4. **Ninth Circuit decision gives weight to taxing consumers on awarded attorney fees.** Under the *Golsen* rule, the U.S. Tax Court follows the precedent of the circuit court of appeals that would hear the appeal in a particular case. Here, because the Eilers reside in the Ninth Circuit, the court made reference to *Sinyard v. Commissioner*, a Ninth Circuit case that held that attorney fees awarded under a fee-shifting provision are taxable to the individual bringing the case. Future consumers residing in the Ninth Circuit will likely receive the same treatment by the tax court if they recover attorneys' fees pursuant to a fee-shifting provision. However, other circuits have not addressed this issue yet directly. It is possible that consumers residing outside of the Ninth Circuit would be treated differently if they are awarded attorneys' fees pursuant to a fee-shifting statute.
5. **An above-the-line deduction under I.R.C. section 62(a)(20) may still be available in certain consumer cases.** While the court has found that the Eilers' claims did not constitute claims involving unlawful discrimination, it did not eliminate the possibility that other consumer claims may still involve civil rights for the purposes of taking an above-the-line deduction. The court did not address whether FCRA claims brought under one of the statute's privacy-related sections qualify as civil rights claims under 62(a)(20), nor did it touch on other common consumer claims like those under provisions of the Fair Debt Collection Practices Act. Consumers may still be able to claim an above-the-line deduction under section 62(a)(20) if they are able to assert claims under statutory provisions with tangible connections to civil rights in their pleadings.
6. **The IRS may pursue taxes in future cases.** Previously, some consumers who received deficiency notices from the IRS over failure to pay taxes on attorneys' fees have been able to reach settlements with the IRS in tax court or convince the IRS through the Taxpayer Advocate service and other informal avenues to waive payment of additional taxes and penalties on attorney fee awards. The IRS's position in *Eiler* indicates that the IRS backs the taxability of attorneys' fees.

Availability of other deductions

Before 2018, consumers who recovered attorneys' fees and costs in their cases could take a below-the-line miscellaneous itemized deduction for those fees. It was a partial, imperfect remedy because below-the-line deductions can only be used to deduct amounts in excess of 2% of a taxpayer's income and they do not impact a taxpayer's Adjusted Gross Income. Even with the deduction, consumers who recovered attorneys' fees would still have some additional tax liability and could potentially be subjected to the Alternative Minimum Tax and lose access to income-dependent tax credits and benefits depending on the amount of attorneys' fees recovered.

The Tax Cut and Jobs Act of 2017 suspended miscellaneous itemized deductions from 2018 to 2025. Before this temporary suspension could sunset, the OBBBA came into effect in 2025 and permanently eliminated miscellaneous itemized deductions.

NACA's ongoing advocacy work

The U.S. Tax Court's decision in *Eiler* reinforces the need for a legislative solution to ensure consumers are not required to pay income on attorneys' fees and costs recovered in their cases. Sen. Catherine Cortez Masto (Nev.) introduced the End Double Taxation of Successful Consumer Claims Act, S. 467 in the U.S. Senate. This bill would amend I.R.C. section 62(a)(20) to explicitly allow an above-the-line deduction for attorneys' fees recovered in cases involving a consumer protection violation, including fees awarded as part of a settlement. Currently, the bill has 6 co-sponsors in the Senate. NACA strongly supports this legislation and is working to build support with House and Senate offices.

Previously, Rep. Steven Horsford (NV) introduced an identical version of the End Double Taxation of Successful Consumer Claims Act in the U.S. House of Representatives in prior legislative sessions. However, Rep. Horsford has not introduced the bill in the current session.