



letters to the editor

Davenport's Solution for the Attorney's Fee Mess: A Capital Idea

To the Editor:

I want to underscore, and quote, Charles Davenport's article "Why Tort Legal Fees Are Not Deductible" *Tax Notes*, Nov. 4, 2002, p. 703. I hope every single reader of *Tax Notes* reads this, because it is so important. It may not be so important to read the case authorities and the bulk of Chuck Davenport's argument. But it is critical to read a couple of his observations, and to read the bulk of his conclusion. In my view, his most important observations are:

- [I]s there any doubt but that expenses should be directly offset against income when they are direct expenses clearly traceable to property? (p. 704)
- [N]etting is the proper accounting and tax treatment and has always been so. (p. 704)
- Whether we treat legal fees incurred in common law and statutory harm cases as costs of the claim or as disposition costs, they should be netted against the recovery before any amount is taken into income. (p. 705)

I quote at length from Chuck's conclusion, which is spot on:

I think the capitalization theory is correct. I am not enamoured of either the add-to-basis-as-cost-of-disposition or the assignment-of-income theories offered here. But either of them is much closer to standard income tax doctrine than deduction of the fees, and they both avoid having the tax system seem like a school of piranha ready to reduce the taxpayer's damages to a mere skeleton.

The courts have wept about being unable to change the result in these cases. They are powerless, so they claim, in the face of what they describe as congressional prerogative. Well, there is unlikely to be any help there. There is no strong legislative advocate for these taxpayers, and little legislation is enacted without a strong legislative advocate.

Besides, the proper treatment of legal fees in these cases is not properly a legislative matter. This question is uniquely one of the dysfunction of our tax administrators, bar, and judiciary. It should be settled by them. Only a strong Chief Counsel

will direct the troops to call off the war eviscerating taxpayers for meager revenue gains. From all appearances, the current Chief Counsel has the proper characteristics. The IRS is deploying great energy winning cases that almost all agree is a disastrous policy. All of this, of course, angers, with good reason, any taxpayer caught in this web. It makes apt Dickens's description of the law. It flows against basic economics and the general sense that only net increases to wealth should be taxed as income. (p. 705)

As a practitioner, I have found some (though certainly not all) IRS employees are sympathetic to the plight of the plaintiff in these legal fee melees. Does the IRS Chief Counsel read *Tax Notes*? Has the IRS Chief Counsel ever had to console a plaintiff who sees his or her recovery eviscerated by a tax that goes beyond any reasonable limits of economic income? Chuck Davenport's article offers a technically correct and principled (what a stellar combination!) way the current tax administration could resolve this mess.

I also want to comment on Professor Brant Hellwig's article, "Judicial Activism Is Not the Solution to the Attorney's Fee Problem," *Tax Notes*, Nov. 4, 2002, p. 693. Most of this article, of course, is about the *Biehl* case, 118 T.C. 467, *Doc 2002-13103* (36 original pages), 2002 TNT 105-4 (2002), and the article by Cohen and Sager, "Kafka at the Tax Court: The Attorney's Fee in Employment Litigation," *Tax Notes*, Sept. 9, 2002, p. 1503. I've already acknowledged that I'm no expert on qualified reimbursement arrangements under section 62(a)(2)(A), and the specific technique questioned in *Biehl* to get rid of Kafka. See "Further Thoughts on the Bad *Biehl* Decision," *Tax Notes*, Sept. 23, 2002, p. 1777.

Nonetheless, the "don't go there" admonition that Professor Hellwig gives to what he terms "judicial activism" is, I think, misplaced. Certainly, *someone* has to address this. While I agree with Professor Hellwig that Congress may deserve the Kafkaesque label more than the Tax Court, I find Chuck Davenport's strong words to the Service, especially to the Chief Counsel, to be a breath of fresh air.

Very truly yours,

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November 11, 2002