Food Fight Over Contingent Attorneys' Fees

To the Editor:

I am writing to comment on the letter by Professor Timothy R. Koski, "Should Clients Escape Tax on Lawsuit Proceeds Retained by Attorneys?" *Tax Notes,* July 2, 2001, p. 93. I do not disagree with much of the summary of the law presented by Professor Koski, nor with his statements that this is an area that needs correction. However, Professor Koski endorses the majority opinion in the Tax Court's *Kenseth* decision, 114 T.C. 399 (2000), *Doc 2000-14845 (98 original pages), 2000 TNT 102-6.*

As such, Professor Koski indicates that the Tax Court itself cannot solve this problem. While it is true that the Tax Court could not technically mandate compliance by all of the circuit courts with its decision, the five Tax Court judges that dissented in *Kenseth* believe the application of the assignment of income doctrine in this context is simply nonsense. The dissenting opinions in *Kenseth* assert that since the assignment of income doctrine was judge-made law to begin with, its modification or interpretation can be judge-made law too. To quote President Lincoln, "I hold these truths to be self evident."

Obviously, there is room for principled disagreement on the attorneys' fee question. But it was the last page of Professor Koski's article that made me bristle. I believe he quite correctly concludes his article with one paragraph acknowledging that there can be differences of opinion on this issue, and that disclosure to clients about the conflict in the circuits is extremely important. However, I do not know whether he is correct that the Supreme Court is now unlikely to resolve the question. I hope he is wrong.

More significantly, I firmly believe Professor Koski is wrong in his strong endorsement, again, on the last page of his article (*Tax Notes*, July 2, 2001, p. 97), that the assignment of income analogy — and repeated references to fruits and trees emanating from such hoary cases as *Lucas v. Earl* — is apropos. As several of the dissenting opinions in *Kenseth* point out, the assignment of income doctrine has its roots (yet another bad metaphor) in related-party transactions. That is at the nub (or seed?) of this question. It is simply tilling in the wrong field (or picking in the wrong orchard) to apply related-party cases like *Lucas v. Earl* and *Helvering v. Horst* to an area such as contingent attorneys' fees.

Spoiled Fruit (and Rotten Metaphors)

Perhaps realizing the weakness of this "fruit and tree" nonsense to the attorneys' fee situation is Professor Koski's own statement that:

> The fact that most assignment of income cases, including the classic cases of *Lucas v. Earl* and *Helvering v. Horst,* involved intra-family transfers does not prevent the assignment of income doctrine from applying to the attorney-client situation. Although gratuitous transfers may warrant special scrutiny, the assignment of income doctrine is equally applicable to arm's length transactions. [Citing *U.S. v. Basye,* 410 U.S. 441 (1973).] *Tax Notes,* July 2, 2001, at p. 97.

It may be that assignment of income doctrine can apply outside the context of related parties, but the rules ought to be entirely different. Traditionally, as the dissents in *Kenseth* recognize, the classic assignment of income situation has always revolved around the related-party orchard.

Fruit and tree metaphors aside, I think it is wrongheaded to suggest that assignments cannot be legally effective, especially at the time when most contingent fee contracts are signed, and when the value of a case normally cannot be determined by anyone with reasonable accuracy — or even with a Ouija board. Professor Koski seems to believe (as, apparently, did the Tax Court majority in *Kenseth*) that somehow it is truly the client who controls the course of the contingent fee litigation. On paper, that may be the client's right.

Yet, having worked with many plaintiffs and many defense counsel on contingent fee litigation over the last 22 years, I firmly believe that plaintiff's counsel in the vast majority of cases controls the plaintiff. Once in a blue moon the plaintiff makes a decision with which the plaintiff's counsel disagrees or which the plaintiff's counsel has not coached from the plaintiff. But tax results ought not to turn on what happens once in a blue moon. The normal moon shining over the orchard ought to control, and it reflects the plaintiff's lawyer firmly in charge in the contingent fee lawsuit.

Finally, I disagree with Professor Koski that any analogy can be found in coupon bonds. Professor Koski uses the example that a taxpayer who owns a coupon-bearing bond with interest payable annually on December 31 cannot escape tax on the interest by assigning the interest coupons. This is the old — here it comes again — fruit and tree metaphor. I submit to Professor Koski (and to all *Tax Notes* readers) that this is not at all what is occurring in the execution of a contingent fee contract.

IRS Letter Ruling 200107019

Moreover, I do not believe that the Internal Revenue Service should view it this way either. Consider the recent issuance of private letter ruling 200107019, *Doc 2001-4799 (13 original pages), 2001 TNT 34-19.* That letter ruling deals with an assignment of a portion of the claims (and a portion of the resulting recovery) in a case to a third-party charity. The ruling sensibly concludes that the portion of the ultimate damage award that was assigned was not taxable to the assigning plaintiff.

Not only do I believe this ruling is correct, I believe it signals the Service's own admission that the assignment of income doctrine cannot be applied laden with the same knee-jerk farming metaphor mentality that was employed in the related party cases that occurred 60 years ago. For details of this ruling, see Wood, "Punitive Damages: Can They Be Assigned to Avoid Income?" *Tax Notes,* June 11, 2001, p. 1905.

While there is certainly room for differences of opinion on this matter, it disturbs me that the supposedly massive 2001 tax legislation (whoopee!) is supposed to provide heaps of tax relief (but I'll believe that when I start to really see it). As a result of the considerable hoopla over the big 2001 act (which, incidentally, is kind of like a collapsible circus big tent in its phaseouts), the attorneys' fee issue, primarily a result of the AMT, is getting less and less sympathy. It is a grave injustice if this problem is not fixed.

I clearly agree with Professor Koski that it is vital that clients (and counsel) are informed about the split in the circuits and what can only be characterized with a nontechnical term: mess. But unlike Professor Koski, I believe the assignment of income doctrine does not, and should not, be considered to apply to property rights — attorneys' lien or no attorneys' lien — which should exist from the inception of the attorney-client relationship in the contingent fee attorney. As a practical contract matter, my experience suggests this is truly the relationship that prevails. Taxation ought to follow the reality of this relationship. I wish Lee Sheppard or some other vocal tax justice soothsayer would get on this particular bandwagon.

Very truly yours,

Robert W. Wood
Robert W. Wood, P.C.
San Francisco
www.robertwwood.com