



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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Dear _____ :

This letter responds to your request for information dated August 28, 2008, on an employee's tax treatment and the employer's reporting obligation of attorneys' fees paid pursuant to a fee-shifting statute.

Employee's Income Tax Treatment

Courts have agreed with the IRS that a taxpayer must include in gross income fees awarded under a fee-shifting statute. *Sinyard v. Commissioner*, T.C. Memo. 1998-364, *aff'd*, 268 F.3d 756 (9th Cir. 2001); *Vincent v. Commissioner*, T.C. Memo 2005-95; *Ballmer v. Commissioner*, T.C. Memo. 2007-295. This result applies regardless whether the fees are paid directly to the attorney.

The American Jobs Creation Act of 2004 (AJCA) added section 62(a)(20) of the Internal Revenue Code. Under this provision, a taxpayer may deduct from gross income attorneys' fees and court costs paid in connection with any action involving a claim of "unlawful discrimination" as defined in section 62(e). This provision is effective for fees and costs paid after October 22, 2004 with respect to judgments and settlements occurring after said date. Prior to the effective date, an employee generally could deduct attorneys' fees and costs only as a miscellaneous itemized deduction on Schedule A. Thus, many taxpayers became subject to the Alternative Minimum Tax because miscellaneous itemized deductions are not deductible in computing alternative minimum taxable income. See § 56(b)(2)(A)(i). With the enactment of §62(a)(20), however, taxpayers may deduct the fees and costs "above-the-line", *i.e.*, to arrive at adjusted gross income.

Employer's Reporting Obligation

The employer's obligation to report payments in excess of \$600 is imposed by law, not by agreement of the parties. An employer must report in Box 3 of a Form 1099-MISC

issued to an employee an award or other payment of attorneys' fees. This payment may be combined with other non-wage payments, e.g., compensatory damages. The employer must also report in Box 14 of a Form 1099-MISC any fees paid directly to the attorney. See § 1.6045-5(f) of the Income Tax Regulations, Example 3.

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See section 2.04 of Rev. Proc. 2008-1, 2008-1 I.R.B. 1. If you have any additional questions, please contact our office at

Sincerely,

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