



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

OFFICE OF
CHIEF COUNSEL

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Dear

I am responding to your letter dated June 07, 2005, on behalf of your constituent, . asked whether the holding of the Supreme Court of the United States in *Commissioner v. Banks*, 125 S.Ct. 826 (2005), that a taxpayer must include as income a contingent fee paid to his attorney, affects the treatment of attorney fees in the Eleventh Circuit.

The Internal Revenue Service has consistently taken the position that a taxpayer must include in gross income the entire amount of a taxable settlement or judgment, including any contingent fee paid to his attorney. The Courts of Appeals for the Second, Third, Fourth, Seventh, and Federal Circuits, and a different panel of the Ninth Circuit agreed that a taxpayer could not exclude the contingent fee from gross income. However, the Fifth, Sixth, and Eleventh Circuits had held that only the net recovery (judgment less the attorney's contingent fee) is includible in gross income. See *Davis v. Commissioner*, 210 F.3d 1346 (11th Cir. 2000) and *Foster v. United States*, 249 F.3d 1275 (11th Cir. 2001).

In *Banks*, the Supreme Court agreed with our position that, under the anticipatory assignment of income doctrine, a taxpayer must include in income the attorney's fee paid directly to his attorney under a contingent fee agreement. The Supreme Court decision resolved a conflict among the circuits on this issue, thereby overruling the Eleventh Circuit decisions.

When the Supreme Court applies a rule of federal law to the parties before it, that rule is the controlling interpretation of federal law and must be applied to all open tax years. *Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 97 (1993). Thus, the Supreme Court's opinion in *Banks* applies to taxpayers in the Eleventh Circuit for all open tax years, including tax years before the date the Supreme Court rendered its opinion.

Until the Supreme Court renders an opinion on an issue, taxpayers may rely on the opinion of the circuit to which their cases are appealable. This reliance, however, does not shield taxpayers from liability for additional tax and statutory interest if the Supreme Court later disagrees with the decision of that circuit and the tax year is still open. The IRS generally will not assess a penalty for negligence, however, if at the time a taxpayer filed his income tax return, the law of the taxpayer's circuit was inconsistent with the Supreme Court opinion ultimately deciding the law on this issue.

I hope this information is helpful. If you have any questions, please call or me at .

Sincerely,

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