



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

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OFFICE OF  
CHIEF COUNSEL

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The Honorable Barbara Boxer  
United States Senator  
1700 Montgomery Street  
Suite 240  
San Francisco, CA 94111

Attention: Omar Torres

Dear Senator Boxer:

I apologize for the delay in responding to your letter dated May 19, 2005, on behalf of your constituent, . In effect, he wants relief from the law taxing the attorneys' fees portion of the proceeds received in settlement of a *qui tam* action against his former employer.

On October 4, 2004, settled his case for \$369,000 and paid \$147,600 of the settlement proceeds for attorneys' fees. entire \$369,000 settlement is considered gross income under section 61 of the Internal Revenue Code (the Code). Further, his deduction for attorneys' fees was subject to the 2% floor on itemized deductions under section 67 of the Code and the overall limitation on itemized deductions in section 68 of the Code. For alternative minimum tax (AMT) purposes, his attorneys' fees were not deductible under section 56 of the Code. Despite the perceived harshness of the rule, the Supreme Court confirmed the legal correctness of that result in *Commissioner v. Banks*, 125 S. Ct. 826 (2005).

While *Banks* was pending before the Supreme Court, the Congress amended section 62 of the Code to provide relief from the perceived harshness of the previous rule. The American Jobs Creation Act of 2004 added section 62(a)(20) of the Code, effectively exempting deductions for attorneys' fees in unlawful discrimination actions from the 2% floor, from the overall limit on itemized deductions, and from the AMT disallowance. Taxpayers can now deduct all attorneys' fees ("above-the-line") for actions similar to case. This amendment significantly reduces the net taxable amount of many recoveries.

In *Banks*, however, the Supreme Court noted that this provision did not aid the taxpayers before the Court because the Congress intended it to apply prospectively. Unfortunately, received his settlement about three weeks before October 22, 2004, the effective date of section 62(a)(20) of the Code. We do not have

the authority to grant relief from that statutory cut-off. Only the Congress can change the effective date to cover situation.

I hope this information was helpful. If you have further questions, please call me at , or , Identification Number , at .

Sincerely,

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