Nos. 03-892 and 03-907

In The
Supreme Court of the United States

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

JOHN W. BANKS, II,

Respondent.

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

SIGITAS J. BANAITIS,

Respondent.

On Writs Of Certiorari To The United States Courts Of Appeals For The Sixth And Ninth Circuits

BRIEF FOR *AMICUS CURIAE* TAXPAYERS AGAINST FRAUD EDUCATION FUND IN SUPPORT OF RESPONDENTS

CHARLES J. COOPER
Counsel of Record
HAMISH P.M. HUME
COOPER & KIRK, PLLC
1500 K Street, N.W., Suite 200
Washington, D.C. 20005
(202) 220-9600

Counsel for Amicus Curiae Taxpayers Against Fraud, The False Claims Legal Action Center

August 18, 2004

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES – Continued

Page

STATUTES

OTHER

INTEREST OF *AMICUS CURIAE*

Amicus curiae Taxpayers Against Fraud Education Fund ("TAF"), is a nonprofit public interest organization dedicated to combating fraud against the federal government through the promotion of the *qui tam* provisions of the False Claims Act, 31 U.S.C. § 3729 *et seq.* (2004) ("FCA") and the support of whistleblowers who use the Act.[1] The *qui tam* provisions of the FCA permit a private relator to file suit on behalf of the United States alleging violations of the FCA. In addition, the FCA provides for a portion of any recovery generated by such a suit to be paid to the *qui tam* relator who brought the case. Typically, FCA relators will hire attorneys on a contingency fee basis (indeed, two circuits have held that FCA relators are prohibited from bringing their actions *pro se*).[2] TAF therefore has a strong interest in ensuring that contingency fee payments paid to lawyers representing *qui tam* relators are not includible in the taxable income of those *qui tam* relators.

SUMMARY OF ARGUMENT

1. The "assignment of income" doctrine operates as a judicial gloss on the interpretation of the federal tax code: where a taxpayer assigns to another party an item of revenue that he has "earned" (or "is otherwise the source

[1] Pursuant to Supreme Court Rule 37.6, counsel for *amicus* represents that it authored this brief and that no person other than counsel or *amicus* made a monetary contribution to its preparation or submission. All parties have consented to the filing of this brief.

[2] *See United States ex rel. Lu v. Ou*, 368 F.3d 773 (7th Cir. 2004); *United States v. Onan*, 190 F.2d 1 (8th Cir. 1951).

of the right to receive and enjoy"), the assignor taxpayer will be required to include that revenue in his taxable income. This doctrine typically does not apply, however, where the assignor taxpayer has "gone into business with" the assignee, such as where the taxpayer assigns his income to a partnership, to a corporation, or to a principal of which he is the agent.

When a plaintiff hires a lawyer on a contingency fee basis, he and the lawyer have in a very real sense joined together in an enterprise – the enterprise of converting the plaintiff's cause of action into money damages. It is well established that where two taxpayers undertake a joint venture, they may be treated as a partnership for tax purposes, even if they have not formally established a partnership under state law. Thus, since the assignment of income doctrine is not invoked to override the assignments of income agreed upon between bona fide partners, it ought not apply in the contingency fee context. Both the plaintiff and his lawyer are individually taxable on their respective shares of any final damage award or settlement, according to their agreed upon shares. There is no basis for requiring both the plaintiff and the lawyer to pay tax on the amount paid to the lawyer.

2. Even if the Court concludes that respondents in the instant cases must include in their taxable incomes amounts paid to their attorneys as contingency fees, it should recognize that a very different case is presented by a *qui tam* relator under the FCA. Because the FCA relator is not advancing his own cause of action, but is instead advancing a claim belonging solely to the Government, he cannot properly be described as the one who "earns" or "is otherwise the source of the right to receive and enjoy" the income. Rather, he is merely an assignee himself, both of

the Government's cause of action and of a certain portion – from 15 to 30 percent – of any recovery received from that cause of action. In sub-assigning a portion of his own assigned share to a lawyer under a contingency fee agreement, the FCA relator has not assigned his own income, but has instead sub-assigned a portion of the Government's income. Therefore, the logical predicate for applying the assignment of income doctrine does not exist in the FCA context.

Indeed, it is commonplace for multiple FCA relators to combine their knowledge of a defendant's wrongdoing, and to bring a *qui tam* action together, or to merge their efforts after filing separate *qui tam* cases. In this context, it is unthinkable that the IRS would seek to tax any one of the co-relators on the full amount of the FCA bounty that is paid out to all of them. Rather, it is common practice for each relator to include in his taxable income only that portion of the FCA reward that he or she actually receives. Just so, where a lawyer, like an additional relator, is paid a separate share of the FCA reward, that portion should be taxable only to the lawyer.

Any other result would contradict the policy Congress sought to advance in enacting and amending the FCA. That policy is clear: to provide a financial incentive sufficient to encourage *qui tam* relators to root out and expose fraud against the Government, and to discourage Government contractors from engaging in such fraud in the first place. Forcing *qui tam* relators to pay tax on the contingency fee amounts paid to their lawyers will reduce the total incentive to the relator by close to 50 percent. Since there is certainly no evidence that Congress understood that relators would be subject to the "assignment of income" doctrine when it amended the FCA in 1986, applying any such result to the FCA context would be in conflict with Congressional intent.

ARGUMENT

I. The "Assignment Of Income" Doctrine Does Not Require A Plaintiff To Include The Contingency Fee Portion Of An Award In His Taxable Income

The Government asserts that this case can be resolved solely by reference to the federal law proposition "that income is to be taxed to the person who earns it, even when it is paid at that person's direction to someone else." Pet. Br. at 11 (citing *Lucas v. Earl*, 281 U.S. 111, 114-15 (1930)). For that reason, the Government says that it is unnecessary to determine "the precise nature and scope of the right obtained by an attorney pursuant to a contingent fee agreement." Pet. Br. at 12. All that is required is to determine the identity of the plaintiff, and to tax him or her on the full amount of any judgment or settlement procured in the litigation, disregarding any contract, assignment, or other arrangement entered into by that plaintiff. In addition, of course, the Government will tax the lawyer on the amounts he receives from the plaintiff. Thus, applying the assignment of income doctrine in this context results in two taxpayers paying tax on the same revenue: according to the Government, both the plaintiff and the lawyer must include the contingency fee in their taxable income.

To be sure, the Government concedes that the Internal Revenue Code "'creates no property rights but merely attaches consequences, federally defined, to rights created under state law.'" Pet. Br. at 15 (quoting *United States v.*

National Bank of Commerce, 472 U.S. 713, 722 (1985)). Nevertheless, the Government asserts that "under any view of state law" the respondents are taxable on the full amount of the settlement proceeds arising out of their lawsuits because federal tax law will simply disregard any attempted assignment of an interest in said settlements to their lawyers. In support of this assertion, the Government invokes the "assignment of income" doctrine, which holds "that a taxpayer cannot avoid the rule that income is taxed to the person who earns it by making an anticipatory assignment of income, even where the taxpayer assigns income that he has not yet earned the right to receive." Pet. Br. at 19.

The Government's use of this doctrine to require plaintiffs to pay income tax on the contingency fees earned by their lawyers has, unsurprisingly, led to a split in the circuits. The two seminal decisions by this Court establishing the assignment of income doctrine arose in very different contexts: in both cases, a taxpayer sought to assign a portion of his future income to a family member as a tax-free gift, thereby allowing the income to be enjoyed free of any income tax. *See Lucas v. Earl*, 281 U.S. 111, 113-14 (1930) (husband sought to assign future salary to wife); *Helvering v. Horst*, 311 U.S. 112, 114 (1940) (father sought to assign bond coupons to son). In that context, where the income interest is being assigned *from* "the person who earns it," and where the assignee of the income interest has done nothing in exchange for the gift and will pay no tax on that gift, it is not difficult to see why this Court would apply a judicial doctrine designed to ensure that the Tax Code would "tax salaries to those *who earned them* and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it." *Earl*, 281 U.S. at 114-15 (emphasis added).

It is difficult, however, to understand why this assignment of income doctrine should apply where the income interest is being transferred *to* the person who "earns it," and who will also pay tax on it. Indeed, in a variety of ordinary commercial contexts, the assignment of income doctrine clearly is not applied, and valid assignments are made and respected by the Tax Code. For example, it is obviously permissible for a taxpayer to enter into a partnership with another taxpayer, and to agree that any income he earns on certain kinds of projects will be assigned to the partnership, to be distributed according to the allocation of partnership shares. *See generally* 26 U.S.C. §§ 701-704 (2004); *Schneer v. Commissioner*, 97 T.C. 643 (1991) (portion of lawyer's fees generated from work performed for one client were properly assigned to firm subsequently joined by the lawyer). Likewise, the tax law will normally respect as valid an individual's assignment to a corporation of a portion of the income to be earned by the taxpayer's services or from his property. *See generally Investment Research Assoc. v. Commissioner*, 78 T.C.M. (CCH) 951, 1071 (1999) (summarizing circumstances in which taxpayers may assign personal service income to a personal service corporation). It is also well-established that where an agent earns money that it is obligated to pay over to its principal, that money is excluded from the gross income of the agent, and is included only in the gross income of the principal. *See generally* 1965-2 C.B. 21 (Rev. Rul. 65-282) (where lawyer represents indigent client and is awarded attorneys fees that he is obligated to pay over to legal aid society, the awarded fees are included in the gross income only of the legal aid society).[3]

Thus, the resolution of the issue presented in this case depends upon whether a plaintiff's assignment to his lawyer of a portion of the proceeds from a lawsuit, in exchange for legal services, is more akin to (a) a gift of income to one who has not provided anything in return, or (b) a commercial arrangement in which the lawyer essentially becomes a risk-sharing partner with the plaintiff in their joint venture to successfully prosecute a legal claim. Four circuits have concluded that, at least under certain state laws, a plaintiff's contingency fee arrangement with his lawyer is more akin to a joint venture, and that therefore the plaintiff is not taxable on that portion of a judgment or settlement which he must pay to his lawyers in accordance with their prior agreement.[4]

These cases generally recognize that a plaintiff's cause of action typically will have significant value only if advanced by a competent lawyer. Since both the plaintiff who has the cause of action and the lawyer who enables him to advance the claim assume the risk that the claim

[3] Indeed, in a context that seems indistinguishable from the instant cases, the IRS has recognized that the portion of a settlement used to cover attorney fees should not be included in the gross income of the plaintiffs. *See* 1980-2 C.B. 294 (Rev. Rul. 80-364) (where union sues employer on behalf of members and receives settlement payment, members do not have to include in their gross income the amount of the settlement that is kept by the union to cover its attorney fees).

[4] In addition to the decisions below of the Sixth and Ninth Circuits, the following cases were likewise decided in favor of the taxpayer on this issue: *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959); *Srivastava v. Commissioner*, 220 F.3d 353 (5th Cir. 2000); *Estate of Clarks v. United States*, 202 F.3d 854 (6th Cir. 2000); *Foster v. United States*, 249 F.3d 1275 (11th Cir. 2001).

will fail, they both "earn" the income ultimately yielded by the litigation of that claim. Accordingly, both parties should be taxed on any income produced by the action in accordance with the ratios set forth in their prior agreement on how to divide the income between them.

Perhaps the best illustration of this analysis can be found in the first case to address the application of the assignment of income doctrine to the contingency fee context. In *Cotnam v. Commissioner*, 263 F.2d 119 (5th Cir. 1959), the taxpayer claimed an entitlement to a portion of the estate of a man she had served as a personal attendant during the last years of his life. When the Administrator of the decedent's estate refused to recognize Mrs. Cotnam's claim, "she was a long way from having the equivalent of cash," and therefore was also a long way from realizing any income for tax purposes. 263 F.2d at 125. Indeed, to convert her legal claim into any form of taxable income, Mrs. Cotnam was effectively required to hire an attorney:

> Her claim had no fair market value, and it was doubtful and uncertain as to whether it had any value. The only economic benefit she could then derive from her claim was to use a part of it in helping her to collect the remainder. Accordingly she, in effect, assigned to her attorneys forty per cent of the claim in order that she might collect the remaining sixty per cent. That was not the assignment of income of Mrs. Cotnam within the doctrine of *Lucas v. Earl*.

Id. (citation omitted).

In short, hiring a lawyer on contingency fee can be likened to a standard partnership or joint venture in which one party agrees to share the income from a certain asset if the other party agrees to perform services that are thought to be critically important in generating income from that asset. In such a context, unlike the husband-to-wife assignment in *Earl*, it is simply not accurate to assert that the taxpayer is trying to attribute fruits "to a different tree from that on which they grew." *Earl*, 281 U.S. at 115. Rather, as the Fifth Circuit recognized in *Cotnam*, the plaintiff's tree "had borne no fruit and would have been barren if she had not transferred a part interest in that tree to her attorneys, who then rendered the services necessary to bring forth the fruit." 263 F.2d at 126.

To be sure, where the lawyer is paid on an hourly-fee basis, the plaintiff will have to pay tax on the full amount of any recovery, and can be said to have paid the lawyer on an "after-tax" basis. But that is also true of the farmer who chooses to pay a laborer to tend to his trees: the farmer will pay tax on the full amount of income earned from the fruit of his trees, and must pay for his labor on an "after-tax" basis. Where the farmer, however, chooses instead to form a partnership with his laborer, with both parties taking on the risks of the enterprise in exchange for a share of whatever the trees might produce, that joint venture will be taxed as a partnership – i.e., the farmer will include in his taxable income only the amount that he has not assigned away to his "partner," the laborer. *See, e.g., Baughn v. Commissioner*, 28 T.C.M. (CCH) 1447 (1969) (where substance of taxpayers' arrangement was a partnership, it will be taxed as a partnership even if taxpayers did not utilize the partnership form); *see also United States ex rel. Perler v. Papandon*, 331 F.3d 52, 55 (2d Cir. 2003) (citing *Baughn* for proposition that "[I]ndividuals may constitute a partnership for tax purposes even though they expressly disclaim any intention to enter into a partnership relation." 28 T.C.M. (CCH) at 1456.).

In sum, this Court should recognize the critical distinction between a partner who shares risk, and a service-provider who is paid irrespective of outcome. Even if the two are bound by professional ethics to provide identical services under either construct, as a matter of economic reality, there is a world of difference between the two. Ordinarily, the tax law recognizes this difference by taxing the "partner" differently from the service provider. The same result should obtain where the risk-taking partner is a lawyer working on a contingency fee basis.

II. Under No Circumstances Should The Contingency Fee Portion Of A *Qui Tam* Award Be Included In The Taxable Income Of A False Claims Act Relator

Even if the Court concludes that plaintiffs such as Banks and Banaitis must pay tax on contingency fee amounts paid to their lawyers, *amicus curiae* TAF respectfully submits that the Court should explicitly recognize that the taxation of contingency fee payments made to lawyers representing FCA relators presents an entirely distinct question, not presented in this appeal. Furthermore, as explained below, FCA relators should not be taxed on contingency fee payments.

A. An FCA Relator Does Not Advance His Own Cause Of Action, But Is Merely An Assignee Of The Government's FCA Claim

The Government's central argument in these cases proceeds from the following premise:

> There is no doubt that, under any view of state law, respondents were the sole plaintiffs in their

> causes of action and would have been required to include the entire taxable proceeds from those causes of action in their gross income if the proceeds had been paid directly to them. Indeed, by their nature, the basis of respondents' claims was the recovery of lost income.

Pet. Br. at 16. Given that respondents were the "sole plaintiffs" seeking "the recovery of lost income," – they are the ones, according to the Government, who "actually *earned* the income," and hence must "remain[ ] taxable" on that income even though it is paid to their lawyers. Pet. Br. at 16 (emphasis added) (quoting *Commissioner v. Sunnen*, 333 U.S. 591, 604 (1948)).

This premise is wholly inapposite to the *qui tam* context. An FCA relator is never "the sole plaintiff" and could never possibly be expected to include "the entire taxable proceeds" in his gross income. Unlike the typical plaintiff advancing his own cause of action, the *qui tam* plaintiff is advancing a cause of action *on behalf of* the United States Government. *See, e.g.*, 31 U.S.C. § 3730(b)(1) (2004) (authorizing *qui tam* action "in the name of the Government"). Indeed, in upholding the relator's Article III standing to bring a *qui tam* action, this Court relied specifically upon "the doctrine that the assignee of a claim has standing to assert the injury in fact suffered by the assignor." *Vermont Agency of Natural Res. v. United States*, 529 U.S. 765, 773 (2000). In so doing, the Court made clear that the *qui tam* relator is not advancing his own cause of action based upon his own injury, but is instead advancing the Government's cause of action based upon its injury. *See id.* at 774 (it is "the United States' injury in fact [that] suffices to confer standing on [the *qui tam* relator]").

A *qui tam* relator's sole interest in an FCA suit is the statutory bounty, which ranges from 15 to 25 percent of any damages recovery for cases in which the Government intervenes, and from 25 to 30 percent for cases in which the Government does not intervene. 31 U.S.C. § 3730(d) (2004). These amounts represent assignments of the *Government's* damages; the relator is merely an assignee of these amounts, and therefore does not "earn" them or claim entitlement to them in the same way that he could an award of his *own* damages. Even if the Government elects not to intervene, so that the relator and his lawyer do all of the work required to uncover the fraud and to successfully litigate the claim to judgment, the relator clearly could not be taxed on the entire amount of that judgment, since it belongs to, and will be paid over to, the Government. Indeed, requiring a *qui tam* relator to include in his taxable income the "entire proceeds" of an FCA recovery would nullify the financial incentives underlying the *qui tam* provisions, for the tax bill on the entire recovery would substantially exceed the bounty.

Moreover, Congress explicitly provided that the amount of the *qui tam* bounty should vary depending upon the relator's contribution to a successful outcome. 31 U.S.C. § 3730(d). Since the relator's contribution to the ultimate outcome will depend in large part on the work and skill of the relator's lawyer, in a very real sense the *qui tam* bounty is "earned" to that extent by the lawyer, and not by the relator. Indeed, by mandating a higher bounty in cases in which the Government declines to intervene, Congress recognized the added value in such cases of the skill and hard work of the relator's lawyer, who therefore can be understood to have *solely* "earned" that amount. In contrast to the typical case of a plaintiff advancing his own cause of action, in the FCA context it is simply not possible to assert that the relator is the party who "earns" or "is the source of" the ultimate damage recovery.

In addition, unlike the typical plaintiff (and unlike respondents here), the *qui tam* relator is not seeking "the recovery of lost income." Pet. Br. at 16. A plaintiff suing for, say, breach of contract or employment discrimination seeks to recover amounts that should have been paid to that plaintiff, and that would have been taxable to that plaintiff had they been properly paid. This fact has been relied upon as supporting the conclusion that the plaintiff must be taxable on the full amount of any damage award, without reduction for contingency fee payments. *See*, *e.g.*, *Kenseth v. Commissioner*, 259 F.3d 881 (7th Cir. 2001) (settlement proceeds were "lost income" and hence taxable to the plaintiff). By contrast, the FCA relator seeks an award of damages to compensate for losses suffered solely by the Government, which is the "real party in interest." *See*, *e.g.*, *United States v. Health Possibilities*, 207 F.3d 335, 341 (6th Cir. 2000) ("Nor does the right to 'conduct' the action annul the government's status as the real-party-in-interest in *qui tam* litigation."). An award or settlement arising out of an FCA case represents the repayment of money that should have been paid solely to the Government, and that would therefore not have been taxable to any party had it been properly paid in the first place. Thus, the damages the FCA relator seeks to recover are not designed to compensate the relator for the loss of income which would have been taxable had it been rightfully paid. Accordingly, the Government's logical predicate for requiring plaintiffs to pay tax on the contingency fees paid to their lawyers is inapplicable in the FCA context.

B. Congress Has Explicitly Provided For The Assignment Of FCA Claims

In explaining the "assignment of income" doctrine, the Government sets forth the following distinction:

> Thus, where a taxpayer assigns income-producing property to another, thereby relinquishing all control over it, that taxpayer gives up the power to use that property in such a way as to realize a gain. But where a taxpayer retains control over an income-producing asset, that taxpayer has the power to gain through the satisfaction of assigning its income to whomever he pleases. Such a gain is gross income.

Pet. Br. at 22 (citing *Horst*, 311 U.S. at 117).

Applying this principle to the context of a plaintiff advancing his own cause of action, the Government argues that such a plaintiff ultimately retains "the sole power to assert and settle [his] cause[ ] of action." Pet. Br. at 25. In other words, the Government equates a plaintiff's control over his cause of action with "retain[ed] control over an income-producing asset," arguing that because a plaintiff's assignment of a portion of the income that might be generated from that controlled "asset" must be disregarded for tax purposes.[5] Because the Government takes this position irrespective of the rights that state law might

[5] The *Cotnam* court, however, explained why it is incorrect to hold that a plaintiff who exchanges a contingency fee promise for legal services has "fully enjoyed the benefit of his (her) economic gain represented by his (her) right to receive income." 263 F.2d at 126. "[W]here the only economic benefit to the taxpayer [from the assignment] was as an aid to the collection of a part of an otherwise worthless claim," the assignment of income doctrine "can have no just or realistic application." *Id.*

attribute to the lawyer who receives a contingency fee interest, it is implicitly asserting that a plaintiff *can never* assign a portion of his cause of action itself (i.e., his "income producing asset") to his attorneys. In other words, at least for federal tax purposes, the Government asserts that a plaintiff's cause of action is "nonassignable."

This argument cannot be applied to the FCA relator. A *qui tam* relator, in contrast to a plaintiff advancing his own cause of action, is litigating a claim that Congress has already decided to partition and assign. Since the entirety of any award or settlement recovered under the FCA is based solely upon the damages suffered by the Government, the bounty paid to the *qui tam* relator is, by definition, an assignment of the Government's FCA claim. Indeed, in upholding the Article III standing of private relators to bring FCA claims, this Court explicitly recognized that "[t]he FCA can reasonably be regarded as effecting a partial assignment of *the Government's damages claim*." *Vermont Agency of Natural Res.*, 529 U.S. at 773 (emphasis added).

Thus, even if this Court accepts the Government's assertion that, for federal tax purposes, a plaintiff's cause of action is "nonassignable," it must recognize that such an assertion simply cannot be made with respect to an FCA claim: since Congress has already assigned a portion of the FCA claim to qualifying relators, it necessarily follows that the FCA claim is "assignable."[6]

[6] Moreover, because the Government is the "real party in interest," an FCA relator does not have the "control" over an FCA case that a plaintiff has over his own cause of action. *See generally United States v. Health Possibilities*, 207 F.3d 335, 341 (6th Cir. 2000) (voluntary dismissal by *qui tam* plaintiff could not be approved without Attorney

(Continued on following page)

C. The Tax Law Should Not Distinguish Between FCA Assignments Made To Other Relators And Those Made To Lawyers

It is a common practice under the *qui tam* provisions of the FCA for multiple relators to file suit with respect to the same or similar wrongdoing. While there are first-to-file rules in the FCA that prohibit "tag along" cases, it is very often the case that two or more whistleblowers will combine their knowledge regarding the defendant's wrongdoing and join forces in challenging it. For example, in some circumstances, it may be that no one relator has sufficient knowledge to allege an FCA violation with the particularity required under FED. R. CIV. P. 9(b), and therefore two or more relators are necessary for a valid FCA complaint to be filed. In other instances, multiple different *qui tam* complaints may be filed, and the various relators will subsequently decide that it is in their mutual interest to combine forces, rather than to undertake costly litigation over whether the later-filed complaints should be viewed as separate cases or as prohibited "tag alongs."

In any event, it is commonplace, especially in large cases, that more than one relator will receive a portion of the FCA statutory bounty. Ordinarily, the relators will agree among themselves as to the respective shares of the overall bounty that each should receive. TAF is not aware of a single instance in which the IRS has asserted that one

---

General's consent); *see also United States ex rel. Milam v. University of Texas*, 961 F.2d 46, 50 (4th Cir. 1992) ("[T]he United States is the real party in interest in any False Claims Act suit, even where it permits a *qui tam* relator to pursue the action on its behalf."). For this reason, too, federal tax law should not disregard an FCA relator's assignment of an interest in the ultimate FCA award.

relator in a multiple-relator case must be required to include the entire amount of the statutory bounty in his or her taxable income. Nor can we imagine how such an assertion could ever be successfully advanced: First, where multiple relators have agreed to divide the statutory bounty among themselves, the IRS would have absolutely no basis for asserting that one of those relators should be deemed to have first received the entire amount. Second, requiring any single relator to include the entire amount of a divided bounty in his or her taxable income would massively reduce the incentive structure that Congress so carefully put into place in amending the FCA in 1986.

Thus, it appears established that the 15 to 25 percent bounty paid to qualifying *qui tam* relators (or 25 to 35 percent in nonintervened cases) may be divided and assigned among multiple relators without triggering the "assignment of income" doctrine. And if relators A and B may divide and assign the FCA's statutory bounty without exposing either one of them to federal tax liability on the full amount, then it follows that relator A may make the same kind of assignment to his lawyer. Stated differently, if the tax law's "assignment of income" doctrine does not disregard A's assignment of some portion of the *qui tam* bounty to relator B, then it also should not disregard A's assignment of that same interest to his lawyer.

Furthermore, at least two circuits have held that a relator is not legally permitted to bring an FCA case without a lawyer. *See United States ex rel. Lu v. Ou*, 368 F.3d 773, 775 (7th Cir. 2004) ("*pro se* relator cannot prosecute a *qui tam* action, because he is acting as an attorney for the government" (emphasis added)); *United States v. Onan*, 190 F.2d 1 (8th Cir. 1951) (same). And, as a practical matter, the lawyer rather than the relator often must invest the greater resources into prosecuting an FCA case. Given these two realities, it would be manifestly unfair for the tax law to disregard a relator's assignment of an interest in the *qui tam* award to his lawyer, and to treat the relator as being "in sole control" of the entire case.

D. Public Policy Concerns Dictate That FCA Contingency Fees Should Not Be Taxed To FCA Relators

Finally, there are gravely important public policy concerns relating to the question of how to tax contingent legal fees in the FCA context that are not raised in the present case.[7] Congress has explicitly provided a financial incentive to encourage whistleblowers to step forward and to bring suit in order to vindicate the public interests protected by the statute. *See generally United States ex rel. Ramseyer v. Century Healthcare Corp.*, 90 F.3d 1514, 1520 (10th Cir. 1996) (1986 amendments' expansion of jurisdiction over *qui tam* actions reflects Congress' "concern that the government was not pursuing known instances of fraud.") (citation omitted); *United States ex rel. Fine v. Sandia Corp.*, 70 F.3d 568, 572 (10th Cir. 1995) ("Congress instituted the *qui tam* provisions of the FCA to encourage private citizens to expose fraud that the government itself cannot easily uncover."). *United States v. NEC Corp.*, 11 F.3d 136, 139 (11th Cir. 1993) ("The purpose of the *qui tam* provisions is to provide individuals with incentive to

[7] These concerns are similar to those raised by statutory causes of action with respect to which Congress has provided that the "prevailing party" may recover attorney fees and costs. *See Amici Curiae* Brief of Mountain States Legal Foundation, et al., Nos. 03-892 and 03-907 (U.S. filed Aug. 18, 2004).

inform the government of fraudulent activity and to compensate such relators for the time and expense of coming forward with such information.").[8]

Congress surely intended FCA relators to pay income tax on any amounts actually received under the FCA. But Congress likely did not intend to substantially drain the statutory bounty of its force as an incentive by requiring FCA relators to pay income tax on amounts that they do not actually receive.

For example, consider an FCA case in which the statutory award to the *qui tam* relator is $1 million. Under the Government's tax scheme, the relator's bounty would likely net out to approximately $250,000. The calculation is straightforward. The relator pays a $400,000 tax on the full $1 million (this assumes a 40% combined federal and state tax rate). He then pays an additional $350,000 (35%) to his lawyer, a fee which would not be unreasonable in light of the considerable investment and risk ordinarily associated with FCA cases.[9] If the $350,000 contingency fee paid to the lawyer is not taxable to the relator, his taxable income is $650,000 and his net bounty is thus approximately $390,000. Obviously, the effect of the tax regime advanced by the Government in this case would dramatically reduce the financial incentive offered to *qui tam* relators to come forward – often at great personal

[8] Indeed, the FCA itself provides that successful *qui tam* relators, in addition to being entitled to the statutory bounty, are also entitled to recover attorney fees and costs. 31 U.S.C. § 3730(d)(1) – (2) (2004).

[9] The lawyer then pays a $140,000 (40%) tax on his $350,000 portion of the award, leaving him with $210,000. Thus, the total net, after-tax return to the two individuals responsible for bringing the FCA action would be $460,000, less than half the $1 million bounty.

expense and professional risk – to blow the whistle on those who are defrauding the Government.

CONCLUSION

For the forgoing reasons, the Court should affirm the decisions below, or, at a minimum, reserve the question whether FCA relators must pay income tax on any portion of a statutory bounty paid to their lawyers under a contingency fee agreement.

Dated: August 18, 2004

Respectfully submitted,

CHARLES J. COOPER
Counsel of Record
HAMISH P.M. HUME
COOPER & KIRK, PLLC
1500 K Street, N.W.,
Suite 200
Washington, D.C. 20005
(202) 220-9600

Counsel for Amicus Curiae Taxpayers Against Fraud, The False Claims Legal Action Center