Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States* v. *Detroit Timber & Lumber Co.,* 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

COMMISSIONER OF INTERNAL REVENUE *v.* BANKS

CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 03–892. Argued November 1, 2004—Decided January 24, 2005*

Respondent Banks settled his federal employment discrimination suit against a California state agency and respondent Banaitis settled his Oregon state case against his former employer, but neither included fees paid to their attorneys under contingent-fee agreements as gross income on their federal income tax returns. In each case petitioner Commissioner of Internal Revenue issued a notice of deficiency, which the Tax Court upheld. In Banks' case, the Sixth Circuit reversed in part, finding that the amount Banks paid to his attorney was not includable as gross income. In Banaitis' case, the Ninth Circuit found that because Oregon law grants attorneys a superior lien in the contingent-fee portion of any recovery, that part of Banaitis' settlement was not includable as gross income.

Held: When a litigant's recovery constitutes income, the litigant's income includes the portion of the recovery paid to the attorney as a contingent fee. Pp. 5–12.

(a) Two preliminary observations help clarify why this issue is of consequence. First, taking the legal expenses as miscellaneous itemized deductions would have been of no help to respondents because the Alternative Minimum Tax establishes a tax liability floor and does not allow such deductions. Second, the American Jobs Creation Act of 2004—which amended the Internal Revenue Code to allow a taxpayer, in computing adjusted gross income, to deduct attorney's fees such as those at issue—does not apply here because it was passed after these cases arose and is not retroactive. Pp. 5–6.

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*Together with No. 03–907, *Commissioner of Internal Revenue* v. *Banaitis,* on certiorari to the United States Court of Appeals for the Ninth Circuit.

Syllabus

(b) The Code defines "gross income" broadly to include all economic gains not otherwise exempted. Under the anticipatory assignment of income doctrine, a taxpayer cannot exclude an economic gain from gross income by assigning the gain in advance to another party, *e.g., Lucas* v. *Earl,* 281 U. S. 111, because gains should be taxed "to those who earn them," *id.,* at 114. The doctrine is meant to prevent taxpayers from avoiding taxation through arrangements and contracts devised to prevent income from vesting in the one who earned it. *Id.,* at 115. Because the rule is preventative and motivated by administrative and substantive concerns, this Court does not inquire whether any particular assignment has a discernible tax avoidance purpose. Pp. 6–7.

(c) The Court agrees with the Commissioner that a contingent-fee agreement should be viewed as an anticipatory assignment to the attorney of a portion of the client's income from any litigation recovery. In an ordinary case attribution of income is resolved by asking whether a taxpayer exercises complete dominion over the income in question. However, in the context of anticipatory assignments, where the assignor may not have dominion over the income at the moment of receipt, the question is whether the assignor retains dominion over the income-generating asset. Looking to such control preserves the principle that income should be taxed to the party who earns the income and enjoys the consequent benefits. In the case of a litigation recovery the income-generating asset is the cause of action derived from the plaintiff's legal injury. The plaintiff retains dominion over this asset throughout the litigation. Respondents' counterarguments are rejected. The legal claim's value may be speculative at the moment of the assignment, but the anticipatory assignment doctrine is not limited to instances when the precise dollar value of the assigned income is known in advance. In these cases, the taxpayer retained control over the asset, diverted some of the income produced to another party, and realized a benefit by doing so. Also rejected is respondents' suggestion that the attorney-client relationship be treated as a sort of business partnership or joint venture for tax purposes. In fact, that relationship is a quintessential principal-agent relationship, for the client retains ultimate dominion and control over the underlying claim. The attorney can make tactical decisions without consulting the client, but the client still must determine whether to settle or proceed to judgment and make, as well, other critical decisions. The attorney is an agent who is duty bound to act in the principal's interests, and so it is appropriate to treat the full recovery amount as income to the principal. This rule applies regardless of whether the attorney-client contract or state law confers any special rights or protections on the attorney, so long as such protections do

Syllabus

not alter the relationship's fundamental principal-agent character. The Court declines to comment on other theories proposed by respondents and their *amici,* which were not advanced in earlier stages of the litigation or examined by the Courts of Appeals. Pp. 7–10.

(d) This Court need not address Banks' contention that application of the anticipatory assignment principle would be inconsistent with the purpose of statutory fee-shifting provisions, such as those applicable in his case brought under 42 U. S. C. §§1981, 1983, and 2000(e) *et seq*. He settled his case, and the fee paid to his attorney was calculated based solely on the contingent-fee contract. There was no court-ordered fee award or any indication in his contract with his attorney or the settlement that the contingent fee paid was in lieu of statutory fees that might otherwise have been recovered. Also, the American Jobs Creation Act redresses the concern for many, perhaps most, claims governed by fee-shifting statutes. P. 11.

No. 03–892, 345 F. 3d 373; No. 03–907, 340 F. 3d 1074, reversed and remanded.

KENNEDY, J., delivered the opinion of the Court, in which all other Members joined, except REHNQUIST, C. J., who took no part in the decision of the cases.