

HOUSE BILL REPORT

ESSB 6270

As Reported by House Committee On:
Judiciary

Title: An act relating to attorneys' liens.

Brief Description: Revising provisions relating to attorneys' liens.

Sponsors: Senate Committee on Judiciary (originally sponsored by Senators Esser, Haugen, Sheahan and Kline).

Brief History:

Committee Activity:

Judiciary: 2/24/04, 2/26/04 [DP].

Brief Summary of Engrossed Substitute Bill

- Ends double taxation on attorneys' fees obtained through judgments and settlements in employment discrimination cases and other types of civil suits.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass. Signed by 8 members: Representatives Lantz, Chair; Moeller, Vice Chair; Carrell, Ranking Minority Member; Campbell, Flannigan, Kirby, Lovick and Newhouse.

Minority Report: Do not pass. Signed by 1 member: Representative McMahan, Assistant Ranking Minority Member.

Staff: Sarah Shirey (786-5793); Trudes Hutcheson (786-7384).

Background:

In Washington, successful plaintiffs must pay income tax on attorneys' fees awarded as compensation for claims arising from non-physical injuries, such as employment discrimination. Because these fees are not specifically excluded from "income" as it is defined in the Federal Tax Code, the majority of courts, like Washington, require plaintiffs to include these attorneys' fees in their gross income for federal tax purposes. However, several of the circuit courts have recently created an exception. These

exceptions involve contingency-fee cases in which the relevant state attorneys' lien statute explicitly vests an attorney with a property right in the plaintiff's claim.

In August of 2003, the Ninth Circuit held that state law determines whether plaintiffs must include attorneys' fees awarded in employment discrimination cases as part of their gross income for federal tax purposes. The Court read Oregon's attorney lien statute as not including attorneys' fees as part of a plaintiff's gross income, because Oregon's statute gives the plaintiff's attorney a property interest in the action or judgment and this interest is superior to all others. On the other hand, the Ninth Circuit has found that Alaska's statute forces a plaintiff to include awarded fees when reporting his or her gross income to the IRS. The Court's decision turned on the fact that Alaska's statute gives an attorney a contractual interest, rather than a property interest, in an action.

The Ninth Circuit has not considered Washington's attorneys' lien statute. However, it has been the practice in Washington to include attorneys' fees as part of a plaintiff's gross income. This practice has significantly impacted a recent case before the Washington Appellate Court, *Blaney v. International Assoc. of Machinists*. There the court ordered the defendant to pay the taxes incurred by the plaintiff as a consequence of the judgement in addition to the award. This substantially increased the damages. The case is now pending before the Washington Supreme Court.

An attorneys' lien is a legal right or interest that an attorney has in a client's money or property, or in the money payable to the client as a settlement or judgment. Washington's attorneys' lien statute only grants an attorney a lien for attorneys' fees on the judgment and not the cause of action. Therefore, attorneys have no lien rights on pre-judgment settlements.

Summary of Bill:

An attorney has a lien for his or her compensation on the monetary sum received in an action before final judgment once the action has been commenced. The amount of the lien may be up to the value of any services performed by the attorney in the action, or the amount due under any special agreement.

Attorneys have the same property rights and power to enforce their liens as their clients for the monetary amount due to them in an action or a judgment. The attorneys' lien on both actions and judgments is superior to all other liens except child support. The attorneys' liens on actions is not affected by settlement between the parties to the action until the attorneys' lien for fees is paid in full.

Proceeds are defined as the monetary sum received in an action. The definition is limited to identifiable cash proceeds in accordance with the Uniform Commercial Code.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: This legislation is a way to end the double taxation paid by successful plaintiffs in some civil suits. The bill only addresses a federal tax issue, and will not have any effect on Washington state taxes. Attorneys should pay taxes on the attorney's fees they are awarded in a successful suit. However, the taxes need not be paid twice. Plaintiffs should not pay taxes on these fees, as they never see this money. There are cases in which this double taxation has resulted in a plaintiff owing more in income tax than he or she actually received in compensation. In addition, double taxation has a bad impact on business in the state, as it forces employers to pay additional damages, and it acts as an impediment to settlement.

Testimony Against: None.

Persons Testifying: Andrea Brenneke, Center for Changing Workforce and Washington State Bar Association.

Persons Signed In To Testify But Not Testifying: None.