



The Civil Rights Tax Relief Act: The end of double taxation of attorney's fees in unlawful discrimination cases

By Emily R. Frank

Successful plaintiffs in unlawful discrimination cases will no longer be paying more money than they won thanks to a new law ending double taxation of attorney's fees in such cases. President Bush signed into law the American Jobs Creation Act of 2004 on October 22, 2004. Section 703, the Civil Rights Tax Relief Act (the "CRTRA"), excludes awards that plaintiffs win in unlawful discrimination claims from taxable income.

Formerly, successful plaintiffs who won or settled employment discrimination and related cases paid taxes on the award they received as compensation for unlawful discrimination and on any amount awarded as attorney's fees. Attorneys also paid taxes on their fees, thus resulting in double taxation of the attorney's fees award. While the new law will not affect the taxes attorneys pay on their fees, the law will eliminate such fees from the gross income of those who receive a judgment or settlement. Successful plaintiffs will be able to deduct the fees and costs paid to their attorneys.

Attorney's fees under prior law were included in the individual's gross income, then deducted as a "miscellaneous itemized deduction." This treatment resulted in some individuals being taxed on the merit-based award and the attorney's fees award. Prior law often triggered the alternative minimum tax, thus taxing a larger portion of the award. This tax treatment meant that some plaintiffs, including those receiving only injunctive relief, paid more in taxes than the value of the award itself.

The CRTRA also provides for income averaging of back pay awards. Before the new law, back pay

awards were not income-averaged. Instead, the Internal Revenue Service taxed the total back pay award in the year received. This resulted in some individuals being placed in a higher tax bracket than they would have been in if they had received their wages over the years for which the award compensated them. Now, back pay awards will be taxed over the number of years that the award compensates.

The Act applies to judgments or settlements occurring after the date of enactment, October 22, 2004. Two consolidated cases pending before the U.S. Supreme Court, *Commissioner v. Banks and Commissioner v. Banaitis*, address relief for individuals with awards and settlements that have already been paid. Although not an exhaustive list, unlawful discrimination for purposes of the CRTRA includes unlawful acts under specific sections of the Civil Rights Acts of 1964 and 1991, the Age Discrimination in Employment Act of 1967, the Family and Medical Leave Act of 1993, and the Americans with Disabilities Act of 1990.

Further Information

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