

108TH CONGRESS
1ST SESSION

S. 887

To amend the Internal Revenue Code of 1986 to apply an excise tax to excessive attorneys fees for legal judgments, settlements, or agreements that operate as a tax.

IN THE SENATE OF THE UNITED STATES

APRIL 10, 2003

Mr. KYL (for himself and Mr. CORNYN) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to apply an excise tax to excessive attorneys fees for legal judgments, settlements, or agreements that operate as a tax.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Intermediate Sanctions
5 Compensatory Revenue Adjustment Act of 2003”
6 (ISCRAA).

1 **SEC. 2. EXCISE TAXES ON EXCESS FEE TRANSACTIONS OF**
 2 **CERTAIN ATTORNEYS.**

3 (a) IN GENERAL.—Subchapter D of chapter 42 of the
 4 Internal Revenue Code of 1986 (relating to failure by cer-
 5 tain charitable organizations to meet certain qualification
 6 requirements) is amended by adding at the end the fol-
 7 lowing new section:

8 **“SEC. 4959. TAXES ON EXCESS FEE TRANSACTIONS.**

9 “(a) INITIAL TAXES.—There is hereby imposed on
 10 the collecting attorney in each excess fee transaction a tax
 11 equal to 5 percent of the excess fee. The tax imposed by
 12 this paragraph shall be paid by any collecting attorney re-
 13 ferred to in subsection (f)(1) with respect to such trans-
 14 action.

15 “(b) ADDITIONAL TAX ON THE COLLECTING ATTOR-
 16 NEY.—In any case in which a tax is imposed by subsection
 17 (a) on an excess fee transaction and the excess fee involved
 18 in such transaction is not corrected within the taxable pe-
 19 riod, there is hereby imposed a tax equal to 200 percent
 20 of the excess fee involved. The tax imposed by this para-
 21 graph shall be paid by any collecting attorney referred to
 22 in subsection (f)(1) with respect to such transaction.

23 “(c) EXCESS FEE TRANSACTION; EXCESS FEE.—For
 24 purposes of this section—

25 “(1) EXCESS FEE TRANSACTION.—

1 “(A) IN GENERAL.—The term ‘excess fee
2 transaction’ means any transaction in which a
3 fee is provided by an applicable plaintiff (in-
4 cluding payments resulting from litigation on
5 behalf of an applicable plaintiff determined on
6 an hourly or percentage basis, whether such fee
7 is paid from the applicable plaintiff’s recovery,
8 pursuant to a separately negotiated agreement,
9 or in any other manner), directly or indirectly,
10 to or for the use of any collecting attorney with
11 respect to such applicable plaintiff if the
12 amount of the fee provided exceeds the value of
13 the services received in exchange therefor or
14 subsection (g)(1) applies.

15 “(B) DETERMINATION OF VALUE.—For
16 purposes of subparagraph (A), in determining
17 whether the amount of the fee provided exceeds
18 the value of the services received in exchange
19 therefor, the value of the services shall be the
20 sum of—

21 “(i) the reasonable expenses incurred
22 by the collecting attorney in the course of
23 the representation of the applicable plain-
24 tiff, and

25 “(ii) a reasonable fee based on—

1 “(I) the number of hours of non-
2 duplicative, professional quality legal
3 work provided by the collecting attor-
4 ney of material value to the outcome
5 of the representation of the applicable
6 plaintiff, taking into account the fac-
7 tors described in subparagraphs (B)
8 and (D) of subsection (h)(2),

9 “(II) reasonable hourly rates for
10 the individuals performing such work
11 based on hourly rates charged by
12 other attorneys for the rendition of
13 comparable services, including rates
14 charged by adversary defense counsel
15 in the representation, taking into ac-
16 count the factors described in sub-
17 paragraphs (A), (C), (E), and (G) of
18 subsection (h)(2), and

19 “(III) to the extent such items
20 are not taken into account in estab-
21 lishing the reasonable hourly rates
22 under subclause (II), an appropriate
23 adjustment rate determined in accord-
24 ance with subparagraph (C) to com-
25 pensate the collecting attorney for pe-

1 riods of substantial risk of non-pay-
2 ment of fees and for skillful or inno-
3 vative services which increase the
4 amount of the applicable plaintiff's re-
5 covery.

6 “(C) ADJUSTMENT RATE.—

7 “(i) IN GENERAL.—For purposes of
8 this paragraph, an appropriate adjustment
9 rate is a percentage of the reasonable
10 hourly rate under subparagraph (B)(ii)(II)
11 which is added to the amount of such rate
12 and which is not more than the sum of one
13 risk percentage and one skill percentage
14 described in clauses (ii) and (iii), respec-
15 tively.

16 “(ii) RISK PERCENTAGE.—For pur-
17 poses of this subparagraph, the term ‘risk
18 percentage’ means a percentage rate that
19 is proportional to the collecting attorney’s
20 risk of nonrecovery of fees and which is—

21 “(I) in the case of a collecting at-
22 torney who assumed a substantial risk
23 of nonpayment of fees, not more than
24 100 percent,

1 “(II) in the case of a collecting
2 attorney who assumed a substantial
3 risk of nonpayment of fees and de-
4 voted more than 8,000 hours of legal
5 work (as described in subparagraph
6 (B)(ii)(I)) and more than 2 years to
7 the case before resolution of all
8 claims, not more than 200 percent, or

9 “(III) in the case of a collecting
10 attorney who assumed a substantial
11 risk of nonpayment of fees and de-
12 voted more than 15,000 hours of legal
13 work (as described in subparagraph
14 (B)(ii)(I)) and more than 4 years to
15 the case before resolution of all
16 claims, not more than 300 percent.

17 “(iii) SKILL PERCENTAGE.—For pur-
18 poses of this subparagraph, the term ‘skill
19 percentage’ means, in the case of a col-
20 lecting attorney who has demonstrated ex-
21 ceptionally skillful or innovative legal serv-
22 ice which generated a recovery for the ap-
23 plicable plaintiff substantially greater than
24 the typical recovery in similar cases, a per-
25 centage rate that is proportional to the in-

1 crease in the applicable plaintiff's recovery
2 and that is not more than 100 percent.

3 “(iv) LIMITATION.—An appropriate
4 adjustment rate shall not increase the col-
5 lecting attorney's fee above an amount that
6 is proportional to the applicable plaintiff's
7 recovery.

8 “(D) COURT APPROVAL OF FEES.—Fee
9 payments approved by any court shall be pre-
10 sumed to not be in excess of the value of the
11 services received in exchange therefor if the
12 court approving the fee—

13 “(i) did not approve an adjustment
14 rate greater than that determined to be
15 appropriate under subparagraph (C) in a
16 case where such fee included an adjust-
17 ment rate, and

18 “(ii) obtained and relied upon a report
19 of a legal auditing firm with respect to
20 such fee in accordance with the procedures
21 in subsection (h).

22 “(2) EXCESS FEE.—The term ‘excess fee’
23 means the excess referred to in paragraph (1)(A).

24 “(d) JOINT AND SEVERAL LIABILITY.—For purposes
25 of this section, if more than 1 person is liable for any tax

1 imposed by subsection (a), all such persons shall be jointly
2 and severally liable for such tax.

3 “(e) APPLICABLE PLAINTIFF.—For purposes of this
4 section, the term ‘applicable plaintiff’ means any person
5 represented by a collecting attorney with respect to a claim
6 described in subsection (f)(1).

7 “(f) OTHER DEFINITIONS AND RULES.—For pur-
8 poses of this section—

9 “(1) COLLECTING ATTORNEY.—The term ‘col-
10 lecting attorney’ means any person engaged in the
11 practice of law who represents—

12 “(A) any governmental entity, including
13 any State, municipality, or political subdivision
14 of a State, or any person acting on such enti-
15 ty’s behalf, including pursuant to Federal or
16 State Qui Tam statutes, in a claim for
17 recoupment of payments made or to be made by
18 such entity to or on behalf of any natural per-
19 son by reason, directly or indirectly, of a breach
20 of duty that causes damage to such natural per-
21 son,

22 “(B) any organization described in para-
23 graph (3) or (4) of section 501(c) and exempt
24 from tax under section 501(a), in a claim for
25 damages based on a breach of duty, whether

1 civil or criminal, causing damage to such orga-
2 nization,

3 “(C) any natural person seeking to recover
4 damages in a claim based on breaches of duty,
5 whether civil or criminal, causing damage to
6 such natural person, or

7 “(D) any assignee or other holder of
8 claims described in subparagraph (A), (B), or
9 (C),

10 when 1 or more of such claims, whether or not
11 joined in 1 action, involve the same or a coordinated
12 group of plaintiff’s attorneys or similarly situated
13 defendants, arise out of the same transaction or set
14 of facts or involve substantially similar liability
15 issues, and result in settlements or judgments aggregating at least \$100,000,000.

17 “(2) TAXABLE PERIOD.—The term ‘taxable pe-
18 riod’ means, with respect to any excess fee trans-
19 action, the period beginning with the date on which
20 the transaction occurs and ending 90 days after the
21 earliest of—

22 “(A) the date of the mailing of a notice of
23 deficiency under section 6212 with respect to
24 the tax imposed by subsection (a), or

1 “(B) the date on which the tax imposed by
2 subsection (a) is assessed.

3 “(3) CORRECTION.—

4 “(A) GENERAL RULE.—Any excess fee
5 transaction is corrected by undoing the excess
6 fee to the extent possible and taking any addi-
7 tional measures necessary to place the applica-
8 ble plaintiff in a financial position not worse
9 than that in which such plaintiff would be if the
10 collecting attorney were dealing under the high-
11 est fiduciary standards.

12 “(B) PAYMENT OF EXCESS FEES.—

13 “(i) IN GENERAL.—Except as pro-
14 vided in clause (ii), a collecting attorney
15 corrects an excess fee transaction by pay-
16 ing any excess fees plus interest to the ap-
17 plicable plaintiff.

18 “(ii) CERTAIN SETTLEMENTS.—In the
19 case of excess fees arising from or related
20 to that certain Master Settlement Agree-
21 ment of November 23, 1998, and other,
22 concluded Settlement Agreements based on
23 State health care expenditures pursuant to
24 title XIX of the Social Security Act (42
25 U.S.C. 1396 et seq.), including lawsuits in-

1 volving the States of Florida, Minnesota,
2 Mississippi, and Texas, the collecting at-
3 torney corrects an excess fee transaction
4 by paying any excess fees plus interest to
5 the 50 States in proportion to each State’s
6 share of the United States population.

7 “(C) NO WAIVER OF FEE.—No collecting
8 attorney may avoid imposition of any tax im-
9 posed by this section by transferring any por-
10 tion of the excess fee or refusing to accept any
11 portion of the excess fee.

12 “(g) DISCLOSURE REQUIREMENTS.—

13 “(1) TREATMENT AS EXCESS FEE.—Any fee
14 provided after the date of the enactment of this sub-
15 section by an applicable plaintiff (including pay-
16 ments resulting from litigation on behalf of an appli-
17 cable plaintiff determined on an hourly or percent-
18 age basis, whether such fee is paid from the applica-
19 ble plaintiff’s recovery, pursuant to a separately ne-
20 gotiated agreement, or in any other manner), di-
21 rectly or indirectly, to or for the use of any col-
22 lecting attorney with respect to such applicable
23 plaintiff shall be deemed to be an excess fee provided
24 in an excess fee transaction unless the disclosure re-
25 quirements described in paragraph (2) are met.

1 “(2) CONTENTS OF STATEMENT.—The disclo-
2 sure requirements of this paragraph are met for any
3 taxable year in which a collecting attorney receives
4 any fees with respect to a claim described in sub-
5 section (f)(1), if such collecting attorney—

6 “(A) includes in the return of tax for such
7 taxable year a statement including the informa-
8 tion described in subsection (c)(1) with respect
9 to such claim, and

10 “(B) provides a statement including the in-
11 formation described in subsection (c)(1) to the
12 applicable plaintiff prior to the deadline (includ-
13 ing extensions) for filing such return.

14 “(h) LEGAL AUDITING FIRM.—

15 “(1) IN GENERAL.—In any case before a Fed-
16 eral district court or a State court in which the
17 court approves fees paid to a collecting attorney, the
18 court shall seek bids from legal auditing firms with
19 a specialty in reviewing attorney billings and select
20 1 such legal auditing firm to review the billing
21 records submitted by the collecting attorney, under
22 the same standards the firm would use if it were
23 hired by a private party to review legal bills sub-
24 mitted to the party, for the reasonableness of such
25 attorney’s billing patterns and practices. The court

1 shall require the collecting attorney to submit billing
2 records, cost records, and any other information
3 sought by such firm in its review.

4 “(2) REVIEW BY LEGAL AUDITING FIRM.—In
5 reviewing the billing records and work performed by
6 the collecting attorney, the legal auditing firm shall
7 address all relevant matters, including—

8 “(A) the hourly rates of the collecting at-
9 torney compared with the prevailing market
10 rates for the services rendered by the collecting
11 attorney,

12 “(B) the number of hours worked by the
13 collecting attorney on the case compared with
14 other cases that the collecting attorney worked
15 on during the same period,

16 “(C) whether the collecting attorney per-
17 formed tasks that could have been performed by
18 attorneys with lower billing rates,

19 “(D) whether the collecting attorney used
20 appropriate billing methodology, including keep-
21 ing contemporaneous time records and using
22 appropriate billing time increments,

23 “(E) whether particular tasks were staffed
24 appropriately,

1 “(F) whether the costs and expenses sub-
2 mitted by the collecting attorney were reason-
3 able,

4 “(G) whether the collecting attorney exer-
5 cised billing judgment, and

6 “(H) any other matters normally ad-
7 dressed by the legal auditing firm when review-
8 ing attorney billings for private clients.

9 “(3) FILING OF REPORT; RESPONSE; BURDEN
10 OF PROOF.—The court shall set a date for the filing
11 of the report of the legal auditing firm, and allow
12 the collecting attorney or any applicable plaintiff to
13 respond to the report within a reasonable time pe-
14 riod. The report shall be presumed correct unless re-
15 butted by the collecting attorney or any applicable
16 plaintiff by clear and convincing evidence.

17 “(4) FEE FOR LEGAL AUDITING FIRM.—The fee
18 for the report of the legal auditing firm shall be paid
19 from the collecting attorney’s fee award, the applica-
20 ble plaintiff’s recovery, or both in a manner deter-
21 mined by the court.

22 “(i) REGULATIONS.—The Secretary shall prescribe
23 such regulations as may be necessary or appropriate to
24 carry out this section, including regulations to prevent

1 avoidance of the purposes of this section and regulations
2 requiring recordkeeping and information reporting.”.

3 (b) CONFORMING AND CLERICAL AMENDMENTS.—

4 (1) Subsections (a), (b), and (c) of section 4963
5 of the Internal Revenue Code of 1986 are each
6 amended by inserting “4959,” after “4958,”.

7 (2) Subsection (e) of section 6213 of such Code
8 is amended by inserting “4959 (relating to excess
9 fee transactions),” before “4971”.

10 (3) Paragraphs (2) and (3) of section 7422(g)
11 of such Code are each amended by inserting “4959,”
12 after “4958,”.

13 (4) The heading for subchapter D of chapter 42
14 of such Code is amended to read as follows:

15 **“Subchapter D—Failure by Certain Chari-**
16 **table Organizations and Persons to Meet**
17 **Certain Qualification Requirements and**
18 **Fiduciary Standards”.**

19 (5) The table of subchapters for chapter 42 of
20 such Code is amended by striking the item relating
21 to subchapter D and inserting the following:

“SUBCHAPTER D. Failure by certain charitable organizations and
persons to meet certain qualification requirements
and fiduciary standards”.

1 (6) The table of sections for subchapter D of
 2 chapter 42 of such Code is amended by adding at
 3 the end the following new item:

“Sec. 4959. Taxes on excess fee transactions.”.

4 (c) EFFECTIVE DATE.—The amendments made by
 5 this section shall apply to excess fees paid on or after June
 6 1, 2002.

7 **SEC. 3. DECLARATORY JUDGMENTS RELATING TO EXCISE**
 8 **TAXES ON EXCESS FEE TRANSACTIONS OF**
 9 **CERTAIN ATTORNEYS.**

10 (a) IN GENERAL.—Subchapter B of chapter 76 of the
 11 Internal Revenue Code of 1986 (relating to judicial pro-
 12 ceedings) is amended by redesignating section 7437 as
 13 section 7438 and by inserting after section 7436 the fol-
 14 lowing new section:

15 **“SEC. 7437. DECLARATORY JUDGMENTS RELATING TO TAX**
 16 **ON EXCESS FEE TRANSACTIONS.**

17 “(a) IN GENERAL.—In a case of actual controversy
 18 involving—

19 “(1) a determination by the Secretary or the
 20 collecting attorney with respect to the imposition of
 21 the excise tax on excess fee transactions on such col-
 22 lecting attorney under section 4959, or

23 “(2) a failure by the Secretary or the collecting
 24 attorney to make such a determination,

1 upon the filing of an appropriate pleading by an applicable
2 plaintiff, the Tax Court may make a declaration with re-
3 spect to such determination or failure. Any such declara-
4 tion shall have the force and effect of a decision of the
5 Tax Court and shall be reviewable as such.

6 “(b) DEFERENTIAL REVIEW.—If a collecting attor-
7 ney’s fee has been approved by a court in accordance with
8 section 4959(c)(1)(D) or by the Secretary pursuant to sec-
9 tion 4959, the Tax Court shall review the fee only for an
10 abuse of discretion.

11 “(c) LEGAL AUDITING FIRM.—In any petition for a
12 declaration referred to in subsection (a):

13 “(1) NO PREVIOUS REPORT.—If a report by a
14 legal auditing firm that meets the requirements of
15 section 4959(h) has not been previously produced
16 and relied on by another court, the Tax Court shall
17 hire such a legal auditing firm and rely on its report
18 pursuant to the procedures in section 4959(h).

19 “(2) SECOND REPORT.—

20 “(A) IN GENERAL.—If a report by a legal
21 auditing firm has been approved by a court in
22 accordance with section 4959, the Tax Court
23 shall hire a second legal auditing firm upon the
24 request of the petitioner.

1 “(B) FEE FOR REPORT.—The Tax Court
2 may direct the petitioner to pay the fee for any
3 report of a legal auditing firm provided pursu-
4 ant to subparagraph (A).

5 “(d) TIME FOR BRINGING ACTION.—No proceeding
6 may be initiated under this section by any person until
7 90 days after such person first notifies the Secretary of
8 the excess fee transaction with respect to which the pro-
9 ceeding relates.

10 “(e) DEFINITIONS.—For purposes of this section,
11 any term used in this section and also in section 4959
12 shall have the meaning given such term by section 4959.”.

13 (b) CLERICAL AMENDMENT.—The table of sections
14 for subchapter B of chapter 76 of the Internal Revenue
15 Code of 1986 is amended by striking the item relating to
16 section 7437 and by inserting the following new items:

 “Sec. 7437. Declaratory judgments relating to tax on excess fee transactions.
 “Sec. 7438. Cross references.”.

17 (c) EFFECTIVE DATE.—The amendments made by
18 this section shall apply to actions after the date of the
19 enactment of this Act.

○