

SPEECH OF  
**HON. RON PAUL**  
OF TEXAS  
IN THE HOUSE OF REPRESENTATIVES  
TUESDAY, JUNE 14, 2005

Mr. PAUL. Mr. Speaker, I would like to place in today's record the following article by Mr. Lee Jackson, a constituent of mine who is battling a perverse tax law. Mr. Jackson and several other individuals were the target of a frivolous lawsuit that rightfully was dismissed for its lack of merit. Mr. Jackson and his fellow defendants--all totally blameless--spent many thousands of dollars in legal fees fighting the meritless suit. They understandably filed their own lawsuit against both the original plaintiffs and the plaintiffs' law firm. However, they cannot reach a monetary settlement for damages because our tax code treats all proceeds from such a settlement--even the portion Mr. Jackson owes to his attorneys--as taxable income for Mr. Jackson. As a result, Mr. Jackson literally cannot afford to settle his case because he will owe more in income taxes than he receives from the settlement! Furthermore, he cannot deduct his attorneys fees because of the alternative minimum tax. Mr. Jackson's story, as told below, provides a vivid example of why Congress must change the tax code to ensure that attorney fees are deemed taxable income to the attorneys who actually receive them, not their clients.

**TAXING JUSTICE**  
(By Lee Jackson)

There is perversity in using tax policy to reduce the numbers of frivolous lawsuits. Courts were developed in the first place to adjudicate impartially the relative merit of one person's argument over another's in a dispute. The controlling premise was that courts were best able to sort through facts and opposing arguments in specific cases and arrive at impartial resolutions.

Distrust in the courts has upset the delicate balance between legislature and judiciary. When judges pick and choose laws they will or will not enforce; when they dictate new law from the bench; when their standard strays from the Constitution and looks to current popular thinking and foreign decisions; or when judges bow before the force of political money during confirmation re-election cycles; when those things happen, citizens lose confidence in the ability to achieve justice, and turn to the legislature for relief. Therein lies new danger.

Courts are uniquely suited to try facts of particular cases. Legislatures are not. However, legislatures must react to concerns of constituents, and so they have sought solutions as Americans pressed them to weigh in on the perceived high volume of seemingly frivolous cases that drove up medical and other costs, and seemed to precipitate a downward spiral in quality of crucial services.

Attending these issues were actions of legislatures, courts, and executive branches of government. Take the case of Cynthia Spina, the Illinois Forest Preserve policewoman

who won a judgment against her employer after a six-year sexual-harassment lawsuit. Instead of netting \$300,000 after paying \$1 million to her attorney, she was taxed \$400,000 by the IRS. The law that made such travesty possible was promulgated in 1996 and differentiates between types of damages. Gone is the concept of damages being a monetary amount determined by a jury as the amount necessary to bring a plaintiff back to equilibrium. Justice is now a taxable event.

A new premise seems to permeate the land: That all plaintiffs are suspect, and likely to be greedy money-grubbers forwarding spurious complaints. Such a premise does a disservice to juries whose members receive negligible compensation for their services and to the vast majority of plaintiffs who turn to courts as a last resort.

Consider our case still pending in California. My partner and I appealed to the FBI and the SEC for alleged corporate malfeasance. We also alerted the public via the Internet. For our trouble, we, along with friends and family were sued personally for \$60 million. The courts in California found we had done nothing wrong and further, that we were sued primarily to silence us.

In effect, the courts in California were used as a weapon to interfere with our rights to free speech. Along the way, this case resulted in a binding precedent extending First Amendment rights to the Internet. That precedent has been used all the way to the US Supreme Court as well as in several state supreme courts.

Left with hundreds of thousands of dollars in legal bills accumulated for our defense, we sought to recover through the courts. As we proceeded, we became aware of the Spina case, and feared that the same tax provisions could apply to us.

What we found was even more perverse. Spina's debacle resulted because the attorney's fee was charged as income to her, and then Alternative Minimum Tax (AMT) was applied. In tax court, Spina pleaded the unfairness with the judge, who sympathized with her but said his hands were tied by law (a fine time to be a strict constructionist! I think it intuitively obvious to the casual observer that a US government that taxes a citizen more than the citizen receives is breaking a Constitutional proscription somewhere!).

In the California case, we (the erstwhile defendants) became plaintiffs in pursuit of recovery of our legal expense and other damages. It is worth mentioning that our wives were also sued, and another couple as well. Neither our wives nor the other couple were even alleged to have done anything wrong--they were sued in order to bring pressure on us. My partner and I live in Texas. The other couple lives in Maine.

We soon learned of a difference in treatment depending upon residence. In Texas, the legislature had defined attorneys' fees as belonging to attorneys, and therefore not taxable to plaintiffs. In Maine, no such determination had been made. Also, the Federal District court in which Texas lies had decided that damages were not subject to Alternative Minimum Taxes. The federal court district in which Maine lies had decided the opposite. As a result, the Maine plaintiffs could expect to realize an after-tax net that would have been an estimated 1/15<sup>th</sup> of the net that the Texas plaintiffs could have expected on the same estimated award. Ironically, all we plaintiffs in our case had been subjected to the exact same set of circumstances; we would have appeared together in the same court; and, if damages were awarded, they would have been determined by the exact same jury.

Enter the Supreme Court. In January, 2005, the Supreme Court issued a decision that decreed equal federal tax treatment among all plaintiffs across the breadth of the United States; that attorneys' fees should be taxed to plaintiffs; and that Alternative Minimum Taxes apply. In effect, the Supreme Court's decision put almost all plaintiffs in the same tax position as Spina. Taken to its logical and viable extreme, this decision puts civil courts off limits as an alternative to violence to resolve bona fide disputes.

There is an exemption to that decision. Inspired by the Spina case, Congress last year passed the Civil Rights Tax Relief Act. It provided that, in Civil Rights cases, attorneys' fees would not be taxed to plaintiffs (on the basis that the amount had been taxed twice-- first to plaintiffs, then to attorneys). Unfortunately for Spina, the law was not made retroactive, so as of this moment, she still contends with the IRS over her tax bill. However, other plaintiffs with similar cases realized tremendous relief.

Not so for us in our California case, and thousands of other plaintiffs also facing ruinous taxes after winning their cases. Clearly the courts in California were used as a weapon to infringe on our civil rights. However, in that underlying case, we were then defendants. When we filed suit to recover damages, the case was characterized differently and was no longer, technically, a civil rights case. Our dilemma had been to seek court assistance to recover, or face paying our legal expense for our own defense in the underlying case for years to come. It did not occur to us at the time we filed with the court that we could win and end up owing an even greater amount to the IRS.

That is the effect of the Supreme Court ruling. Because ours is technically not a civil rights case, we do not enjoy the benefits of the exemption inspired by the Spina case. We had properly appealed to our government for help, and the government has now placed us in a position where our own best interests are indeterminate, so we cannot settle (ironic, since the intent of most tort reform has been to encourage settlement). When a jury makes an award, the tax exposure will likely be ruinous. Another irony is that the higher the award, the greater our tax exposure. And we are middle-class citizens.

The basis on which the Supreme Court decided that attorneys' fees are taxed as income to plaintiffs is that plaintiffs pay attorneys; that the amount they pay comes to them as a result of the award; that money to pay attorneys was something they did not have prior to the award, and therefore coming, as it would from the award, must be income. The rationale is held irrelevant (in contingency cases) that attorneys receive payment only if and after an actual award is received and that there is shared risk between plaintiff and attorney.

There is another problem with taxing awards as income, and this is even more poignant. As mentioned earlier, awards are a jury's determination of the monetary equivalent of restoring a client to equilibrium (without consideration for tax consequences). By definition, plaintiffs owned that equivalent value prior to the need to seek court intervention and thus is not income.

Where back wages are sought and won, obviously income is received. However, even in those cases there should be no more taxes assessed or collected than would have been had the plaintiff been paid normally.

Another major factor that should weigh in favor of plaintiffs and obviate taxes on awards is that courts, state legislatures, and Congress establish the rules under which a citizen

seeks justice. A plaintiff going into court in pro per is in extreme jeopardy of losing over factors as innocuous as presenting the case in a form that violates local-court determined rules. When citizens are sued, they often have no choice but to retain the very best legal expertise possible. When they win their cases and are left with oppressive debt, they should have recourse to the courts for relief without incurring even more horrendous debt to the government. The idea is laughable that people would willingly choose to spend their hard-earned income and scarce time to be in court for recreation (i.e. the "pursuit of happiness").

The concept of exemptions presents its own difficulties. By legislatively determining that some cases are entitled to favorable tax treatment over others, lawmakers are making judgments over relative merits of cases in advance of either a judge or jury examining specific facts. On its face, such policy screams violation of Constitutional equal protection and equal access to the courts. Justice is no longer blind. And to the extent that such laws continue, the Federal government becomes complicit in chilling citizen participation on issues such as the ones in our case in California. Bad guys already know this, and they know that as a result, they can do bad things to good people with impunity. The combined branches of government have evolved those conditions.

At present, there is legislative effort under way to cure the situation for plaintiffs excluded by current exemptions. There is also a strong Congressional move to abolish AMT altogether. (That would be a great thing for the country, but a subject for another time.) A danger for plaintiffs is that, should AMT be abolished, a strong sense could devolve that the plight of plaintiffs would then be resolved. Such is not the case.

AMT only increases the degree of travesty. Eliminating them for plaintiffs still leaves them exposed to ordinary tax rates (think of an ordinary citizen paying taxes on a \$1 million award, half of which goes to pay attorneys, and much of which goes to pay other expenses. The citizen could still be in a break-even or deficit position, and certainly one that in no way approaches restoration or justice.).

Studying ways to include others in exemptions is self-defeating. There are too many circumstances to contemplate and leaves citizens with the dubious proposition of having to seek a legislative solution after having won in court. It further requires the impossible task of timing the court decision such that it is issued only after the passage of the legislation in order to be sure that the new law protects them (retroactivity is frowned upon in the House).

The real issues are: Should any legislature ever be deciding relative merit of any civil dispute over any other civil dispute by creating rapacious tax laws and then establishing exemptions? (As soon as they do so, they create violations of equal protection and access.) Should the government ever be entitled to a share of what a jury has decided is the amount required to restore a plaintiff to equilibrium? (Every dollar taxed on an award is a dollar subtraction from that plaintiff's restoration as determined by a jury after due deliberation over all facts pertinent to the case--justice becomes impossible as a practical and mathematical matter). Should attorneys' fees be taxed to plaintiffs? (The government is going to tax that amount to the attorney. When the attorney is retained on a contingency basis, both attorney and plaintiff are entering into a transaction that is high risk with no gain for either unless they win at court. And, it is the courts, Congress, and state legislators that set the conditions under which requiring an attorney for any court proceeding is mandated as a practical matter for most citizens.)

If the answer to each of the above questions is "no" (and I think a reasonable man would conclude that is the correct answer for each question), then the proper legislative response is easy: Define attorneys' fees as belonging to attorneys; and, do away with taxes on awards.

If both of those actions are taken, plaintiffs with bona fide complaints rightfully will enjoy a full measure of restoration to equilibrium as determined by a jury of their peers. Admittedly, that allows for occasionally rewarding miscreants. The alternative ensures penalizing law-abiding citizens who have already suffered.

Adopting the above leaves unsettled how to discourage frivolous cases. There are other ways to do that including award limits, and attorney fee caps. However, the solution cannot and must not include provisions that deny justice and impose further penalties on law-abiding citizens who appeal to their governments.

As these things are contemplated, a figurative call to arms is in order. Taxes imposed on individual citizens across the breadth of the original Thirteen Colonies in our early history were only a fraction of the burden thrust on individual contemporary citizens now carrying these burdens. These unjustly treated citizens already number in thousands; and their numbers will grow rapidly as effects of the Supreme Court decision become felt.

It is hard to conceive of a single congressional district left unaffected. Corrective action should be swift.

Citizens that must contend with government taxes and tax collecting agencies of the government after prevailing in court are denied justice. Allowing them to negotiate to a reduced amount after the fact is neither justice nor a solution--it is a mockery and refutation of the most fundamental principles which gave birth to our great country and for which patriots gave their lives.

In contemplating concepts of taxing justice, it is appropriate to recall that plaintiffs seek court resolution as an alternative to violence; that they pay in advance for their "day in court" through normal taxes; that in entering court, they demonstrate tremendous faith in their fellow citizens and government; that the aim of court is to return prevailing plaintiffs to equilibrium; and that if plaintiffs are successful, they are entitled to an assumption of having brought a bona fide complaint. To require more is to delay justice, and in that regard, it is well to remember William Gladstone's words: "Justice delayed is justice denied."

Or as Theodore Roosevelt said, "Justice consists not in being neutral between right and wrong, but in finding out the right and upholding it, wherever found, against the wrong." Leaving citizens stranded in bewildering circumstances that destroy pursuit of happiness and is brought about by poorly thought out government action is wrong. Correcting quickly is right.