

108TH CONGRESS  
1ST SESSION

# H. R. 1926

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.

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## IN THE HOUSE OF REPRESENTATIVES

MAY 1, 2003

Mr. HAYWORTH introduced the following bill; which was referred to the Committee on Ways and Means

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## 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          “(4) LIMITED REASONABLE CAUSE.—For pur-  
13          poses of section 4962(a), an excess fee transaction  
14          shall not be treated as an event which was due to  
15          reasonable cause if the amount of the fee provided  
16          would exceed the value of the services received in ex-  
17          change therefor determined with the maximum ad-  
18          justment rate allowed under subsection (c)(1)(C).

19          “(g) DISCLOSURE REQUIREMENTS.—

20          “(1) TREATMENT AS EXCESS FEE.—Any fee  
21          provided after the date of the enactment of this sub-  
22          section by an applicable plaintiff (including pay-  
23          ments resulting from litigation on behalf of an appli-  
24          cable plaintiff determined on an hourly or percent-  
25          age basis, whether such fee is paid from the applica-

1 ble plaintiff's recovery, pursuant to a separately ne-  
2 gotiated agreement, or in any other manner), di-  
3 rectly or indirectly, to or for the use of any col-  
4 lecting attorney with respect to such applicable  
5 plaintiff shall be deemed to be an excess fee provided  
6 in an excess fee transaction unless the disclosure re-  
7 quirements described in paragraph (2) are met.

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

13 “(A) includes in the return of tax for such  
14 taxable year a statement including the informa-  
15 tion described in subsection (c)(1) with respect  
16 to such claim, and

17 “(B) provides a statement including the in-  
18 formation described in subsection (c)(1) to the  
19 applicable plaintiff prior to the deadline (includ-  
20 ing extensions) for filing such return.

21 “(h) LEGAL AUDITING FIRM.—

22 “(1) IN GENERAL.—In any case before a Fed-  
23 eral district court or a State court in which the  
24 court approves fees paid to a collecting attorney, the  
25 court shall seek bids from legal auditing firms with

1 a specialty in reviewing attorney billings and select  
2 1 such legal auditing firm to review the billing  
3 records submitted by the collecting attorney, under  
4 the same standards the firm would use if it were  
5 hired by a private party to review legal bills sub-  
6 mitted to the party, for the reasonableness of such  
7 attorney's billing patterns and practices. The court  
8 shall require the collecting attorney to submit billing  
9 records, cost records, and any other information  
10 sought by such firm in its review.

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

15 “(A) the hourly rates of the collecting at-  
16 torney compared with the prevailing market  
17 rates for the services rendered by the collecting  
18 attorney,

19 “(B) the number of hours worked by the  
20 collecting attorney on the case compared with  
21 other cases that the collecting attorney worked  
22 on during the same period,

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

1           “(D) whether the collecting attorney used  
2           appropriate billing methodology, including keep-  
3           ing contemporaneous time records and using  
4           appropriate billing time increments,

5           “(E) whether particular tasks were staffed  
6           appropriately,

7           “(F) whether the costs and expenses sub-  
8           mitted by the collecting attorney were reason-  
9           able,

10           “(G) whether the collecting attorney exer-  
11           cised billing judgment, and

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

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

23           “(4) FEE FOR LEGAL AUDITING FIRM.—The fee  
24           for the report of the legal auditing firm shall be paid  
25           from the collecting attorney’s fee award, the applica-

1 ble plaintiff's recovery, or both in a manner deter-  
2 mined by the court.

3 “(i) REGULATIONS.—The Secretary shall prescribe  
4 such regulations as may be necessary or appropriate to  
5 carry out this section, including regulations to prevent  
6 avoidance of the purposes of this section and regulations  
7 requiring recordkeeping and information reporting.”.

8 (b) CONFORMING AND CLERICAL AMENDMENTS.—

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

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

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

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

1 **“Subchapter D—Failure by Certain Charitable Organizations and Persons to Meet**  
 2 **Certain Qualification Requirements and**  
 3 **Fiduciary Standards”.**  
 4

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

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

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

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

11 (c) EFFECTIVE DATE.—The amendments made by  
 12 this section shall apply to excess fees paid on or after June  
 13 1, 2002.

14 **SEC. 3. DECLARATORY JUDGMENTS RELATING TO EXCISE**  
 15 **TAXES ON EXCESS FEE TRANSACTIONS OF**  
 16 **CERTAIN ATTORNEYS.**

17 (a) IN GENERAL.—Subchapter B of chapter 76 of the  
 18 Internal Revenue Code of 1986 (relating to judicial pro-  
 19 ceedings) is amended by redesignating section 7437 as  
 20 section 7438 and by inserting after section 7436 the fol-  
 21 lowing new section:

1 **“SEC. 7437. DECLARATORY JUDGMENTS RELATING TO TAX**  
2 **ON EXCESS FEE TRANSACTIONS.**

3 “(a) IN GENERAL.—In a case of actual controversy  
4 involving—

5 “(1) a determination by the Secretary or the  
6 collecting attorney with respect to the imposition of  
7 the excise tax on excess fee transactions on such col-  
8 lecting attorney under section 4959, or

9 “(2) a failure by the Secretary or the collecting  
10 attorney to make such a determination,  
11 upon the filing of an appropriate pleading by an applicable  
12 plaintiff, the Tax Court may make a declaration with re-  
13 spect to such determination or failure. Any such declara-  
14 tion shall have the force and effect of a decision of the  
15 Tax Court and shall be reviewable as such.

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

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

23 “(1) NO PREVIOUS REPORT.—If a report by a  
24 legal auditing firm that meets the requirements of  
25 section 4959(h) has not been previously produced  
26 and relied on by another court, the Tax Court shall

1 hire such a legal auditing firm and rely on its report  
2 pursuant to the procedures in section 4959(h).

3 “(2) SECOND REPORT.—

4 “(A) IN GENERAL.—If a report by a legal  
5 auditing firm has been approved by a court in  
6 accordance with section 4959, the Tax Court  
7 shall hire a second legal auditing firm upon the  
8 request of the petitioner.

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

13 “(d) TIME FOR BRINGING ACTION.—No proceeding  
14 may be initiated under this section by any person until  
15 90 days after such person first notifies the Secretary of  
16 the excess fee transaction with respect to which the pro-  
17 ceeding relates.

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

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

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

1       (c) EFFECTIVE DATE.—The amendments made by  
2 this section shall apply to actions after the date of the  
3 enactment of this Act.

○