1 T.C. 1160 (1943)

An attorney's contingent fee, even if structured as an assignment of a portion of the client's recovery, is taxed as ordinary income, not as a capital gain from the sale of a capital asset.

Summary

Martin Ansorge, an attorney, received a power of attorney from DeLuca, granting him 40% of any recovery from a claim against the United States Shipping Board Emergency Fleet Corporation for expropriated ship contracts. Ansorge argued that this 40% was an assignment of a capital asset and should be taxed as a capital gain. The Tax Court disagreed, holding that the fee was ordinary income. The court reasoned that the assignment was essentially a contingent fee arrangement, and any purported assignment was void under federal law prohibiting assignment of claims against the U.S. prior to allowance of the claim.

Facts

DeLuca hired attorney Ansorge in 1932 to pursue a claim against the United States Shipping Board Emergency Fleet Corporation for the expropriation of ship contracts. The agreement provided Ansorge with 40% of any recovery as compensation for his services, secured by a lien and purportedly assigned to him. Ansorge, through his efforts, secured a private act of Congress allowing DeLuca to sue the U.S. in the Court of Claims. A judgment of $1,615,329.32 was obtained in 1936 and paid in 1937, with Ansorge receiving $161,946.41.

Procedural History

Ansorge reported the income as a capital gain on his 1937 tax return, claiming the 40% assignment was a capital asset held for over two years. The Commissioner of Internal Revenue determined the entire amount was taxable as ordinary income, resulting in a deficiency. Ansorge petitioned the Tax Court for redetermination.

Issue(s)

Whether the attorney's fee received by Ansorge should be taxed as ordinary income or as a capital gain under Section 117 of the Revenue Act of 1936, based on the assignment clause in the power of attorney.

Holding

No, because the purported assignment was essentially a contingent fee arrangement and also void under federal law, thus the attorney's fee is taxable as ordinary income.

Court's Reasoning

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The Tax Court reasoned that the assignment was, in substance, a contingent fee agreement. Crucially, Section 3477 of the Revised Statutes prohibits the assignment of claims against the United States before the claim is allowed, the amount ascertained, and a warrant issued for payment. The court quoted from *National Bank of Commerce v. Downie,* stating the language of the statute embraces "every claim against the United States, however arising, of whatever nature it may be, and wherever and whenever presented." Because the assignment occurred long before these conditions were met, it was considered void. Citing *Pittman v. United States*, the court noted that such assignments are "mere naked powers of attorney, revocable at pleasure." The court also pointed out that Ansorge himself, in the Court of Claims petition, stated that DeLuca was the sole owner of the claim and that no assignment had occurred. The court found that the language assigning a percentage of recovery was merely intended to secure Ansorge's attorney's fee. Finally, the court suggested the agreement might be champertous, further undermining the argument that it constituted a valid assignment of a capital asset.

Practical Implications

This case clarifies that structuring attorney's fees as an assignment of a portion of a client's claim, especially against the U.S. government, will not automatically transform the fee into a capital gain. Attorneys should be aware of Section 3477 of the Revised Statutes and its impact on assignments of claims against the U.S. for tax purposes. The case emphasizes that the substance of the transaction, rather than its form, will determine its tax treatment. Subsequent cases have cited *Ansorge* to support the principle that assignments of claims against the government, made before allowance, are generally ineffective for creating capital gains. It also highlights the importance of consistent representations in court filings, as conflicting statements can undermine a party's position.

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