Campbell v. Commissioner, 134 T. C. 20 (2010) (United States Tax Court, 2010)

In Campbell v. Commissioner, the U. S. Tax Court ruled that a $8. 75 million qui tam payment under the False Claims Act is fully taxable to the recipient, including the portion paid to attorneys as fees. The court also allowed the deduction of these fees as miscellaneous itemized deductions. This decision clarifies the tax treatment of qui tam awards, affirming that they are not exempt as government recoveries and addresses the deductibility of contingency fees, impacting how such settlements are reported and potentially reducing accuracy-related penalties.

Parties

Albert D. Campbell, Petitioner, v. Commissioner of Internal Revenue, Respondent.

Facts

Albert D. Campbell, a former Lockheed Martin employee, initiated two qui tam lawsuits against the company under the False Claims Act (FCA) in 1995, alleging fraudulent billing practices. The U. S. Government intervened in the first suit but not the second. Both suits were settled in September 2003, with Lockheed Martin agreeing to pay the U. S. Government $37. 9 million. As part of the settlement, Campbell received a $8. 75 million qui tam payment for his role as relator. His attorneys withheld a 40% contingency fee, amounting to $3. 5 million, and disbursed the remaining $5. 25 million to Campbell. Campbell reported the $5. 25 million as other income on his 2003 tax return but excluded it from his taxable income calculation. He also disclosed the $3. 5 million attorney's fees on Form 8275 but did not include a citation supporting his position. The IRS issued a notice of deficiency, asserting that the entire $8. 75 million should be included in Campbell's gross income and imposing an accuracy-related penalty.

Procedural History

Campbell filed his 2003 tax return on October 26, 2004, reporting the $5. 25 million as other income but excluding it from taxable income. He also filed Form 8275, disclosing the $3. 5 million attorney's fees. On December 6, 2004, the IRS assessed a tax deficiency of $1,846,108. 63 due to a math error. After further correspondence, Campbell filed an amended return on April 27, 2005, excluding the entire $8. 75 million from gross income. On June 14, 2007, the IRS issued a notice of deficiency, determining a deficiency of $3,044,000 and imposing an accuracy-related penalty of $608,800. Campbell petitioned the Tax Court, which reviewed the case de novo, applying the preponderance of the evidence standard.

Issue(s)

Whether the $8. 75 million qui tam payment received by Campbell is includable in his gross income?

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Whether Campbell substantiated the payment of the $3. 5 million attorney's fees?

If substantiated, whether the $3. 5 million attorney's fees are includable in Campbell's gross income and deductible as a miscellaneous itemized deduction?

Whether Campbell is liable for the accuracy-related penalty under section 6662(a) of the Internal Revenue Code?

Rule(s) of Law

Gross income is defined as "all income from whatever source derived" under section 61(a) of the Internal Revenue Code. Qui tam payments are treated as rewards and are includable in gross income, as established in *Roco v. Commissioner*, 121 T. C. 160 (2003). Contingency fees paid to attorneys are includable in the taxpayer's gross income, as held in *Commissioner v. Banks*, 543 U. S. 426 (2005). Attorney's fees may be deducted as miscellaneous itemized deductions if substantiated, per section 62(a) of the Code. The accuracy-related penalty under section 6662(a) applies to substantial understatements of income tax or negligence, with possible reductions for adequate disclosure and reasonable basis under section 6662(d)(2)(B).

Holding

The entire $8. 75 million qui tam payment is includable in Campbell's gross income. Campbell substantiated the payment of the $3. 5 million attorney's fees, which are includable in his gross income but deductible as miscellaneous itemized deductions. Campbell is liable for the accuracy-related penalty for the substantial understatement of income tax related to the $5. 25 million net proceeds of the qui tam payment but not for the $3. 5 million attorney's fees due to adequate disclosure and a reasonable basis for his position on the fees.

Reasoning

The court reasoned that qui tam payments are taxable as rewards under *Roco v. Commissioner*, rejecting Campbell's argument that the payment was a nontaxable share of the government's recovery. The court distinguished *Vt. Agency of Natural Res. v. United States ex rel. Stevens*, 529 U. S. 765 (2000), which dealt with standing rather than taxability. The court also applied *Commissioner v. Banks*, holding that the $3. 5 million attorney's fees were includable in Campbell's gross income, but allowed their deduction as substantiated miscellaneous itemized deductions. Regarding the accuracy-related penalty, the court found that Campbell's exclusion of the $8. 75 million from gross income resulted in a substantial understatement of income tax. However, the penalty was reduced for the portion related to the attorney's fees due to adequate disclosure and a reasonable basis under section 6662(d)(2)(B). The court rejected Campbell's claim of reasonable cause and good faith for the $5. 25 million net proceeds, citing his failure to seek

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professional advice and reliance on a footnote from *Roco* that was not substantial authority for his position.

Disposition

The Tax Court affirmed the IRS's determination of the income tax deficiency and the accuracy-related penalty with respect to the $5. 25 million net proceeds of the qui tam payment. The penalty was reduced for the portion related to the $3. 5 million attorney's fees.

Significance/Impact

Campbell v. Commissioner clarifies the tax treatment of qui tam payments under the False Claims Act, affirming that they are fully taxable as rewards. The decision also impacts the reporting of such settlements by allowing the deduction of contingency fees as miscellaneous itemized deductions. The ruling on the accuracy-related penalty provides guidance on the application of section 6662, particularly concerning adequate disclosure and reasonable basis for tax positions. This case has significant implications for relators in FCA cases, affecting how they report and potentially reduce penalties related to qui tam awards and associated attorney's fees.

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