ROBINSON & COLE LLP
Labor, Employment & Benefits

Contingent Fees Paid to Attorneys from Amounts Recovered in Litigation are Taxable Income to Clients

John W. Banks, II retained an attorney on a contingent fee basis and sued his former employer, the California Department of Education, for employment discrimination. After leaving his job with the Bank of California, Sigitas Banaitis retained an attorney on a contingent fee basis and sued the bank for wrongful discharge. Banks and Banaitis settled their respective cases, and a portion of each settlement was paid to each attorney in accordance with the fee agreements. Because neither Banks nor Banaitis claimed the amount of the settlement paid to his attorney as gross income on his federal tax return, the Commissioner of Internal Revenue issued each individual a notice of deficiency. Banks and Banaitis each appealed the Tax Court rulings against them to their respective U.S. Court of Appeals. Both courts disagreed with the IRS, finding that a contingency fee payment was not taxable to the client. The IRS appealed to the U.S. Supreme Court in both cases, at which time the cases were consolidated.

In Commissioner of Internal Revenue v. Banks (1/24/05), the U.S. Supreme Court decided that the portion of a money judgment or settlement paid to an attorney under a contingent fee agreement is income to the client under the Internal Revenue Code. The court observed that under the anticipatory assignment of income doctrine, a taxpayer cannot exclude an economic gain from gross income by assigning the gain to another party in advance . The court found that a contingent-fee agreement is an anticipatory assignment from the client to the attorney, because the cause of action that arises from the client's legal injury is an income-generating asset over which the client retains control throughout the litigation. The fact that the value of the cause of action is speculative at the time of the arrangement is of no consequence.

The court noted that Banks' and Banaitis' cases arose before the passage of the American Jobs Creation Act of 2004, which allows a taxpayer to deduct attorney fees and court costs paid by or on behalf of the taxpayer in connection with any action involving a claim of unlawful discrimination when computing adjusted gross income. As the Act is not retroactive, it did not aid Banks and Banaitis, but the court indicated that the Act may cover future taxpayers in Banks' and Banaitis' situation.

Employer's Unconditional Approval of Request for FMLA Leave May Preclude Subsequent Challenges to Entitlement to Leave

Charles Sorrell, a salesman for Rinker Materials Corporation, decided to retire to care for his wife, who had developed an eye disorder. After notifying Rinker of his decision, but before his last day of work, Sorrell learned that he could be entitled to FMLA leave and requested leave in lieu of retirement. Sorrell submitted medical certification and other forms as instructed by Rinker and his leave was officially approved. Before his leave expired, Sorrell contacted Rinker to return to work. At that time, however, Rinker informed Sorrell that his former position was filled and offered him a position requiring more extensive travel than his prior position. Sorrell sued Rinker, claiming that Rinker violated the FMLA by failing to restore him to his prior position or an equivalent position upon his return from leave. Rinker argued that Sorrell was not entitled to leave because, among other reasons, the medical certification he submitted was insufficient. Without addressing whether Sorrell was entitled to FMLA leave, the district court found in favor of Rinker on the grounds that Sorrell had relinquished his position prior to requesting FMLA leave. Sorrell appealed the decision.

Without addressing the relinquishment argument, the U.S. Court of Appeals for the Sixth Circuit ruled in Sorrell v. Rinker Materials Corp. (1/14/05) that the lower court should have resolved the issue of whether Rinker's prior approval of Sorrell's request for leave affected its ability to contest Sorrell's entitlement to leave. The court noted that an employer may be legally barred from disputing an employee's entitlement to leave if, at the time of the request, it unconditionally approved the leave. Moreover, if Rinker believed that the medical certification was inadequate at the time it was submitted, it was obligated under the FMLA to advise Sorrell that the certification was lacking and to provide him with an opportunity to cure any deficiency. The court sent the case back to the lower court, instructing it to resolve whether Rinker was precluded from challenging Sorrell's entitlement to leave in light of its previous unconditional approval of the request.

Licensee of Temporary Agency is Not Liable for Licensor's Alleged Sexual Harassment

Beth Lenoble was an employee of Best Temps, Inc. a headhunter of temporary personnel for employers. Best Temps had a licensing agreement with Photos Temps, Inc., in which Best Temps agreed to provide the use of its trade name and know-how to Photos Temps in exchange for royalties. Although Photos Temps used the Best Temps trade name, the two companies had separate ownership and corporate structures. After her employment with Best Temps ended, Lenoble sued both companies, claiming that she was discriminated against because she was Jewish and a lesbian, in violation of Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 1981, and the Connecticut Fair Employment Practices Act. Specifically, Lenoble argued that her supervisor, the owner of Best Temps, used racial slurs and derogatory language about homosexuality in her presence.

In Lenoble v. Best Temps, Inc. (1/14/05), the U.S. District Court for Connecticut dismissed the claims against Photos Temps because Photos Temps was not Lenoble's employer within the meaning of Title VII and CFEPA. Despite the licensing agreement, the companies did not have sufficiently interrelated operations, common management, centralized control of labor relations, or common ownership to be a single employer. Moreover, because the companies had separate hiring and firing authority, disciplinary practices, and supervisors, they were not joint employers. Although the § 1981 claim did not require Lenoble to show that Photos Temps was her employer, that claim also failed because Lenoble could not show that Photos Temps discriminated against her. There was no evidence that anyone from Photos Temps discriminated against Lenoble, or that Photo Temps could control the actions of Lenoble's supervisor.

Employee Labeled a "Troublemaker" by Employer May Proceed with Retaliation Claim under Title VII

Gigi Castillo, a Filipina woman, was an investigator for the Equal Employment Opportunity Commission. Over the course of several years, and most recently in 1997, Castillo made a number of complaints to the EEOC that various supervisors discriminated against her. In April 1999, Castillo was passed over for a promotion in favor of Joyce Cooper, a black woman. Castillo sued the chairwoman of the EEOC, claiming she was denied the promotion because of her race and sex, and in retaliation for her prior complaints of discrimination, and that she was subjected to a hostile work environment, in violation of Title VII of the Civil Rights Act of 1964.

In Castillo v. Dominguez (1/10/05), the U.S. Court of Appeals for the Ninth Circuit upheld dismissal of the discrimination and harassment claims, but ruled that Castillo could proceed to trial on her retaliation claim. Castillo's discrimination claim failed because she could not show that her employer's reason for the promotion decision, Cooper's superior qualifications, was pretext for discrimination. The harassment claim also failed because, notwithstanding evidence that the EEOC office was an unpleasant place to work, there was no evidence that the working conditions were based on racial or sexual harassment. However, evidence that one or more of Castillo's supervisors labeled her a "troublemaker," advised her that it would be in her best interest not to file a complaint when she was previously passed over for a promotion, and purposefully set her up to fail was sufficient to justify allowing her to pursue her retaliation claim. Although Castillo's complaints were not particularly close in time to the decision not to promote her, this was not enough to bar her from proceeding to trial.

Employee's Subjective Preference for Former Position Does Not Render a Transfer an Adverse Employment Action under Title VII

Brenda O'Neal was an administrative sergeant in the narcotics unit of the City of Chicago Police Department. After the City learned of a rumor that O'Neal had dated a former police officer who had been convicted of selling narcotics, the City transferred O'Neal to a beat sergeant position in one of the districts. The beat sergeant position had the same rank, pay and benefits as O'Neal's former position. O'Neal was replaced in the narcotics unit by a male officer. O'Neal brought a Title VII lawsuit against the City and the decision maker, arguing that the transfer was really a demotion and that she was demoted because of her gender. In O'Neal v. City of Chicago (12/20/04), the U.S. Court of Appeals for the Seventh Circuit dismissed O'Neal's claims. To establish a claim under Title VII, the court observed, an employee must have suffered an adverse employment action. Although O'Neal claimed that the beat sergeant position was less prestigious, offered fewer opportunities for promotion, and offered fewer overtime opportunities, she did not present sufficient objective evidence of these drawbacks. Moreover, the changed job assignments and schedule fell short of an adverse employment action because the responsibilities were within the scope of O'Neal's duties as a sergeant in the police department. O'Neal's complaints about the transfer were based only on a subjective preference for her former position. As O'Neal failed to show more than a mere inconvenience or alteration of job responsibilities, she could not establish any adverse action.

Employee Who Failed to Request Extension of Leave Cannot Pursue Pregnancy Discrimination Claims

Ida Myrick, African American, was employed by Aramark Services, Inc. as a bookkeeper. Myrick suffered complications from pregnancy and went into premature labor in April 2001. Myrick requested a leave of absence from her supervisor and completed the required forms for FMLA leave, including a note from her physician that she would be incapacitated indefinitely. On June 2, 2001, Myrick gave birth and was told by her physician to wait 10 to 12 more weeks before returning to work. Myrick contacted her supervisor on June 4 and again in early July to notify him that she was still on bed rest, but did not formally seek an extension of leave. After Myrick's 12-week FMLA entitlement expired, Aramark replaced Myrick. Myrick learned that she had been terminated when she tried to contact her supervisor on August 8 to announce that she was ready to return to work. Myrick filed suit against Aramark, alleging race and pregnancy discrimination in violation of Title VII and 42 U.S.C. § 1981. Aramark argued that Myrick never formally requested an extension of her leave of absence and was terminated for her failure to return to work when her FMLA leave expired.

In Myrick v. Aramark Services, Inc. (1/12/05), the U.S. Court of Appeals for the Seventh Circuit dismissed Myrick's claims. Myrick presented insufficient evidence to overcome Aramark's non-discriminatory reason for her termination: her failure to return from leave. While other employees were permitted to return to work after extended leave, they were not similarly situated to Myrick because they worked in lower-level positions under a different supervisor. Moreover, although Myrick claimed that her supervisor made racial remarks during her employment, there was no evidence of a link between the termination decision and the supervisor's alleged animosity.

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