

SANDRA L. EDWARDS
6942 HEATHERMOORE LOOP
MONTGOMERY, AL 36117,

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§

STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

Taxpayer, §

DOCKET NO. INC. 06-831

v. §

STATE OF ALABAMA §
DEPARTMENT OF REVENUE.

FINAL ORDER

The Revenue Department assessed Sandra L. Edwards (“Taxpayer”) for 1998 income tax. The Taxpayer appealed to the Administrative Law Division pursuant to Code of Ala. 1975, §40-2A-7(b)(5)a. A hearing was conducted on February 13, 2007. The Taxpayer attended the hearing. Assistant Counsel Gwendolyn Garner represented the Department.

The Department received IRS information indicating that the Taxpayer had failed to report \$20,000 in non-employee compensation received from Victoria Secret Stores in 1998. It consequently assessed the Taxpayer for the tax due, plus penalties and interest. The Taxpayer appealed.

The Taxpayer testified at the February 13 hearing that she received the \$20,000 in issue from a lawsuit settlement, and that she paid \$5,000 of that amount to her attorney. She claims that none of the settlement is taxable. In support of that claim, the Taxpayer submitted a copy of a July 1, 1998 Settlement Agreement, which states that the Taxpayer “[u]nderstands that she is responsible for any tax payments on the above-described check and gift certificate and that the Company will issue a Federal Form 1099 with respect thereto.” The Taxpayer submitted a subsequent agreement dated August 19, 1999, which states – “This agreement will replace the July 1, 1998 settlement agreement.” She asserts

that she is not liable for tax on the settlement money because the subsequent agreement did not state that she was liable. I disagree.

The Taxpayer's liability for Alabama tax is governed by Alabama law, not by an agreement between the Taxpayer and a third party. The settlement proceeds constituted gross income under Alabama law, Code of Ala. 1975, §40-18-14, and are not exempt.

The Taxpayer was also required to report as income the \$5,000 she paid to her attorney. Attorney fees paid to an attorney pursuant to a contingency agreement must be reported as income by the payor/taxpayer. See generally, *Commissioner v. Banks*, 543 U.S. 426 (2005); *Young v. Comm'r*, 240 F.3d 369 (4th Cir. 2001); *Coady v. Comm'r*, 213 F.3d 1187 (9th Cir. 2000).

The Taxpayer indicated at the February 13 hearing that her attorney advised her that even if the proceeds were taxable, she still would not be required to report his \$5,000 fee as income, citing *Cotnam v. Comm'r*, 263 F.2d 199 (5th Cir. 1955). However, *Cotnam* was overturned by the above cited cases. Under current law, the entire amount constituted income to the Taxpayer.

The final assessment is affirmed. Judgment is entered against the Taxpayer for 1998 tax and interest of \$1,002.44. Additional interest is also due from the date the final assessment was entered, August 3, 2006.

Entered February 15, 2007.

BILL THOMPSON
Chief Administrative Law Judge

bt:dr

cc: Gwendolyn B. Garner, Esq.
Sandra L. Edwards
Tony Griggs