



## Bill Analysis

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Sponsor:

Bill Number: SB 1377

Related Bills: See Legislative  
History

Introduced: February 18, 2022  
Amended: April 18, 2022

### SUBJECT

Adjusted Gross Income Deduction for Attorney's Fees and Court Costs Related to Consumer Protection Violation Actions

### SUMMARY

This bill would, under Personal Income Tax Law (PITL), allow a deduction in computing adjusted gross income (AGI) for attorney's fees and court costs in connection with claims relating to litigation of consumer protection violation acts that are included in a taxpayer's income.

### RECOMMENDATION

No position.

### SUMMARY OF AMENDMENTS

The April 18, 2022, amendments made two clarifying changes and added a provision to reduce any itemized deductions for attorney's fees and court costs by the amount of the deduction that would be allowed by this bill.

This is the department's first analysis of the bill.

### REASON FOR THE BILL

The reason for the bill is to allow a deduction for attorney's fees and costs incurred as a result of a product defect or illegal business practice and paid out of the recovery.

### ANALYSIS

This bill would allow a deduction in computing AGI. For taxable years beginning on or after January 1, 2022, a deduction would be allowed for the amount of attorney's fees and court costs included in income by a taxpayer during the taxable year in connection with any litigation involving a claim of a consumer protection violation, as defined.

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This bill would define “consumer protection violation” as an unlawful act under the following:

- United States Code provisions:
  - Section 987 of the General Military Law;
  - Sections 6, 8, or 9 of the Real Estate Settlement Procedures Act of 1974;
  - the Expedited Funds Availability Act;
  - the Homeowners Protection Act of 1998;
  - the Truth in Lending Act;
  - the Credit Repair Organizations Act;
  - the Fair Credit Reporting Act;
  - the Equal Credit Opportunity Act;
  - the Fair Debt Collection Practices Act;
  - the Electronic Fund Transfer Act;
  - the Interstate Land Sales Full Disclosure Act;
  - the Consumer Product Safety Act;
  - the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act; and
  - the Servicemembers Civil Relief Act.
- California Civil Code provisions: Song-Beverly Consumer Warranty Act and Consumer Legal Remedies Act.
- Any provision of federal or state law prohibiting unfair or deceptive trade or credit practices.
- Any provision of federal, state, or local law, including any provision of the laws of another state that provide for the enforcement of consumer protection or regulate any aspect of consumer transactions, including claims for unfair, deceptive, or abusive trade or credit practices, or for other actions that cause harm to an individual by a seller or provider of property, services, securities or other investments, money, or credit for personal, family, or household use.

This bill specifies that any itemized deductions for attorney’s fees and court costs otherwise allowed would be reduced by the amount of the deduction that would be allowed by this bill.

#### *Effective/Operative Date*

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2022.

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### *Federal/State Law*

Under federal law, gross income is defined as all income from whatever source derived, with several exceptions. In *Commissioner v. Banks*, 543 U.S. 426 (2005), the U.S. Supreme Court held that when a recovery constitutes income, the taxpayer's income must include the part of the recovery paid to the attorney as a contingent fee (a fee that is paid only in the case of a successful recovery, generally computed as a percentage of the recovery). Federal law allows an above-the-line deduction for the following amounts related to recoveries from lawsuits for:

- The amount of attorney fees and court costs paid by, or on behalf of, the taxpayer in catch-all discrimination cases (employment and civil rights claims).
- The amount of attorney fees and court costs paid by, or on behalf of, the taxpayer in whistleblower cases.

Legal fees related to producing taxable income are generally deductible as miscellaneous itemized deductions, subject to the federal 2 percent AGI limitation. However, the Tax Cuts and Jobs Act of 2017 (TCJA) suspended miscellaneous itemized deductions until 2025. (TCJA section 11045, adding Internal Revenue Code (IRC) section 67(g).)

For purposes of state income tax law, AGI is defined by cross-reference to the IRC as gross income, which includes all income from whatever source derived, minus specific above-the-line deductions. California does not conform to the suspension of miscellaneous itemized deductions under the TCJA or the federal above-the-line deduction for attorney's fees relating to whistleblower rewards.

California conforms to the federal above-the-line deduction for attorney's fees and court costs incurred in connection with an unlawful discrimination claim, described above.

### *Implementation Considerations*

The bill provides that the taxpayer would be entitled to a deduction for "any provision of federal, state, or local law, including any provision of the laws of another state that provide for the enforcement of consumer protection or regulate any aspect of consumer transactions, including claims for unfair, deceptive, or abusive trade or credit practices, or for other actions that cause harm to an individual by a seller or provider of property, services, securities or other investments, money, or credit for personal, family, or household use." This provision uses terms that are undefined and could be broadly interpreted. For clarity and to avoid taxpayer confusion, it is recommended that the bill be amended to clarify these.

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### *Technical Considerations*

For clarity, in subdivision (a) of Section 17208, it is recommended that the phrase "included in income by a taxpayer" be replaced with "included in the gross income of the taxpayer."

### *Policy Considerations*

This bill would create differences between federal and California tax law.

## **LEGISLATIVE HISTORY**

SB 401(Wolk, Chapter 14, Statutes of 2010), among other things, amended RTC section 17072 to make IRC section 62(a)(21), relating to attorney's fees relating to awards to whistleblowers, not apply.

## **PROGRAM BACKGROUND**

None noted.

## **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

### *Revenue Estimate*

To determine the magnitude of the potential impact to the General Fund, both the frequency of consumer protection violation claims and the dollar amounts of attorney's fees and courts costs associated with these claims must be known. Because it is difficult to predict the frequency of claims and the amount of attorney fees and court costs, the revenue impact is unknown.

However, it is expected that for every \$100,000 of qualified attorney's fees and court costs deducted, the estimated revenue impact would be approximately \$6,000.

## **LEGAL IMPACT**

None noted.

## **APPOINTMENTS**

None noted.

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## **SUPPORT/OPPOSITION**

### *Support*

According to the April 18, 2022, Senate Committee on Governance and Finance analysis, registered support for SB 1377 includes: Bet Tzedek, California Low-income Consumer Coalition, California Reinvestment Coalition, California Rural Legal Assistance Foundation, Calpirg, Consumer Attorneys of California, Consumer Federation of California, Consumer Protection Policy Center/usd School of Law, Consumers for Auto Reliability & Safety, Housing and Economic Rights Advocates and National Consumer Law Center, INC.

### *Opposition*

According to the April 18, 2022, Senate Committee on Governance and Finance analysis, registered opposition for SB 1377 includes: California Chamber of Commerce, California Taxpayers Association, California Teachers Association and Civil Justice Association of California.

## **ARGUMENTS**

None noted.

## **LEGISLATIVE CONTACT**

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