

# CLIENT ALERT

## Employment, Labor & Immigration

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### **Taxation of Attorneys' Fees and Litigation Costs, COBRA, CEPA: New Legislation and Regulations**

There have been recent legislative and regulatory developments of interest to employers. First, the federal government has enacted a new law to correct what has been criticized as the "double taxation" of attorneys' fees incurred by prevailing plaintiffs in employment litigation. Second, the United States Department of Labor has issued new regulations regarding employer obligations under the Consolidated Omnibus Budget Reconciliation Act ("COBRA"). Third, New Jersey has enacted a law amending its whistleblower statute, the Conscientious Employee Protection Act ("CEPA"), to impose new posting requirements on employers.

#### **New Law On The Tax Treatment Of Attorney Fee Awards**

On October 22, 2004, President Bush signed into law a tax bill containing a provision allowing successful plaintiffs in employment law cases to deduct attorney fees and costs from their adjusted gross income. Although the new law expressly applies to attorney fees and costs incurred in civil rights litigation, its broad language covers other types of employment cases as well. It is anticipated that the new law will facilitate settlements by increasing the actual recovery a plaintiff will enjoy without increasing the amount a defendant employer will have to pay.

The law amends the Tax Code's definition of "adjusted gross income," which includes a list of various categories of expenses that may be subtracted from adjusted gross income. Under the old definition, prevailing plaintiffs and their attorneys were both required to pay taxes on attorneys' fee awards. The categories of expenses that may be subtracted from adjusted gross income now include, "attorney fees and court costs

paid by, or on behalf of, the taxpayer in connection with any action involving a claim of unlawful discrimination."

The new law defines the phrase, "unlawful discrimination," very broadly. The phrase includes acts unlawful under various specific laws including, for example, the Age Discrimination in Employment Act ("ADEA"), the Employee Retirement Income Security Act of 1974 ("ERISA"), the Fair Labor Standards Act ("FLSA"), the Family and Medical Leave Act ("FMLA"), the Americans with Disabilities Act ("ADA"), and Title VII of the Civil Rights Act of 1964.

The definition also contains a catchall provision, which expands the definition well beyond traditional discrimination cases. Under the catchall provision, "unlawful discrimination" includes acts unlawful under "[a]ny provision of Federal, State, or local law, or common law claims permitted under Federal, State, or local law ... (i) providing for the enforcement of civil rights, or (ii) regulating any aspect of the employment relationship, including claims for wages, compensation, or benefits, or prohibiting the discharge of an employee, the discrimination against an employee, or any other form of retaliation or reprisal against an employee for asserting rights or taking other actions permitted by law." This broad definition covers most employment disputes, regardless of whether they involve traditional discrimination claims.

The new legislation does not permit plaintiffs to deduct their fees and costs if the deduction would be "in excess of the amount includible in the taxpayer's gross income for the taxable year on account of a judgment or settlement (whether by suit or agreement and whether as lump sum or periodic payments) resulting from such claims." Thus, only successful plaintiffs are entitled to the deduction.

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Finally, the amendments to the definition of “adjusted gross income” apply to “fees and costs paid after [October 22, 2004] with respect to any judgment or settlement occurring after such date.” Because it is prospective, not retroactive, the new law will not affect two cases currently pending before the United States Supreme Court involving the issue of whether attorneys’ fees are taxable, *Commissioner of Internal Revenue v. Banks* and *Commissioner of Internal Revenue v. Banaitis*.

### **New COBRA Notice Requirements**

The United States Department of Labor (“DOL”) finalized regulations regarding the content and timing of notices required under COBRA. The DOL also created some safe harbors for employer compliance and provided model initial coverage and qualifying election notices. Group health plans subject to COBRA must comply with these rules by January 1, 2005.

While the final rules clarify many of the basic notice and disclosure provisions of COBRA, they add new requirements that were not included in the original statute. These new requirements increase a plan’s potential liability for taxes, penalties, and participant claims.

With regard to general notices, the final rules generally give plan administrators a 90-day period from the date an employee first becomes covered under a group health plan to provide the general notice containing information about COBRA rights to the employee and his/her spouse, as required under ERISA. The 90-day period corresponds with the statutory period that an administrator is given to furnish each participant with a copy of the group health plan SPD.

COBRA requires qualified beneficiaries to provide notice to the plan if there is (1) a divorce or legal separation, (2) dependents cease to satisfy the eligibility requirements under the plan, (3) a determination of

disability has been made by the Social Security Administration, and (4) there is a second qualifying event. The final rules require a plan to establish “reasonable procedures” for providing the notice. A procedure is deemed reasonable if it is described in the SPD, specifies who is designated to receive notices, specifies how the qualified beneficiaries must give notice, and specifies the required content of the notice.

The final rules also require that if a plan administrator receives notice of a qualifying event from a participant or beneficiary who is not eligible to receive COBRA, the administrator must provide a notice explaining why there is no coverage. The rules clarify that this notice is required whenever the plan administrator denies coverage after receiving any notice for the beneficiary, regardless of the basis for denial.

Finally, a plan administrator is now required to notify any qualified beneficiary whose COBRA coverage terminates before the maximum COBRA period. This notice must explain the reason the coverage has terminated, provide the date of termination, and describe any rights the qualified beneficiary may have under the plan to elect alternative group or individual coverage, such as a conversion right. The time for providing this notice is “as soon as reasonably practicable” following the administrator’s determination that continuation coverage will terminate. *For further information, please contact Angela Macropoulos at 646-735-3705 or amacropoulos@sillscummis.com*

### **New CEPA Notice Requirements**

On September 14, 2004, New Jersey Governor McGreevey signed legislation amending CEPA, the State’s “whistleblower” statute. CEPA requires employers to post notices of employees’ rights and obligations, including the name of the person designated to receive internal complaints. As of September 14, the

amendment modified these requirements.

First, the amendment enhanced the posting requirements by requiring employers to conspicuously display notice of employee protections, obligations, rights and procedures not only in English, but in Spanish and, at the employer’s discretion, any other language spoken by a majority of the employer’s employees. As before, the notice must include the name of the person or persons the employer has designated to receive written notifications of internal complaints.

Second, the amendment imposes a new requirement on employers with ten or more employees to annually distribute the notice to all employees in written or electronic form.

Lastly, the amendment directs the Commissioner of Labor to make available to employers a text of a sample notice that satisfies the new requirements (although the Commissioner of Labor has not yet done so).

*We send these Alerts to our clients and friends to provide information on recent developments in the law. The Alerts, however, should not be relied on for legal advice in any particular matter.*

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