UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

RICHARD D. BAGLEY, Plaintiff, v. UNITED STATES OF AMERICA, Defendant.	Case No. CV 10-00483-RT(FMOx) FINDINGS OF FACT AND CONCLUSIONS OF LAW

Through this action, Plaintiff Richard D. Bagley ("Bagley") seeks a refund of federal income taxes paid by him in the amount of $3,874,407 with respect to the 2003 tax year. From 1994 through 2003, Bagley, on behalf of the United States of America ("government"), prosecuted TRW Inc. ("TRW") for false claims under the False Claims Act ("FCA"), 31 U.S.C. § 3729 et seq. For his actions as a relator under the FCA, the government paid Bagley a FCA award of $27,244,0000 and statutory attorneys' fees of $9,407,295. Of the $36,651,295 of income, Bagley paid a total of $18,477,815 to his attorneys. On his 2003 amended federal tax refund claim, Bagley reported the $36,651,295 gross income as properly attributable to his "trade or business" of being a private attorney general, and reported the $18,477,815 paid to his private attorneys as ordinary and necessary business expenses deductible pursuant to Section 162 of the Internal Revenue Code. The

Internal Revenue Service ("IRS") denied Bagley's refund claim, stating that the $36,651,295 is "Other Income" as defined in Section 212 of the Internal Revenue Code, and the $18,477,815 paid to Bagley's private attorneys is an itemized deduction reportable on Schedule A.

The court conducted a bench trial on this matter, and now issues its findings of fact and conclusions of law pursuant to Federal Rule of Civil Procedure 52(a). After carefully reviewing all the evidence and hearing argument presented by the parties' counsel, the court makes the following Findings of Fact and Conclusions of Law:

FINDINGS OF FACT[1/]

This is an income tax refund suit filed by Richard D. Bagley ("Bagley"). The Complaint for Refund of Internal Revenue Taxes was filed in Case No. CV-10-00483-RT by Bagley on January 22, 2010. The Defendant is United States of America ("United States" or "Government").

Richard D. Bagley, the Plaintiff, has an MBA and an MS in accounting from UCLA. Bagley is not an attorney and has never been to law school. From 1967 until 1993, Bagley worked for TRW in a variety of positions. During his employment with TRW, Bagley had prior experience with the FCA in 1985when he helped investigate accounting fraud in another office of TRW. Upon Bagley's identification of the source of the accounting fraud, TRW made voluntary disclosures to the Government with respect to these claims.

From 1987 through 1992, Bagley was the Chief Financial Manager for TRW's space and technology group. As Chief Financial Manager for that group, Bagley was responsible for, among other things, contract proposal pricing, indirect expense budgeting and control, and accounting. When Bagley was Chief Financial

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[1/]The Findings of Fact are based on the trial transcripts, the court's notes of trial testimony of witnesses, and the exhibits admitted into evidence.

Manager of the space and technology group at TRW, one of his primary functions was to ensure the integrity of the accounting records and that the bills were sent to the government.

Bagley understood the accounting schemes at TRW and how the costs flowed through the accounting system into the invoices and payment requests which TRW submitted to the government for payment. Starting about 1989 and continuing through 1991, during his employment with TRW, Bagley became aware of false claims made by TRW to the government.

On or about March 29, 1991, Bagley signed a certification to the Federal government that TRW's "indirect" expense claim for the TRW Space and Technology Group for 1990 represented reimbursable costs. The certification was under penalty of perjury and, at the time he signed it, Bagley believed that it was incorrect. Bagley signed another certification to the Federal government verifying TRW's "indirect" expense claim for TRW's 1991 year. He also signed the 1991 certification under penalty of perjury even though he did not believe it was correct at that time.

In TRW's 1990 and 1991 indirect expense certifications, Bagley certified, to the best of his knowledge and belief, that he had reviewed each year's Indirect Cost Proposal, that all costs in the proposal were allowable in accordance with the requirement contracts, that the proposal included no costs that were unallowable, and that all costs were properly allocable to in accordance with applicable regulations. Bagley signed the certifications to the government even though he knew they were wrong in order to retain his job. At that time, Bagley had not initiated FCA proceedings against the government. When Bagley discovered the information regarding TRW's false claims, he discussed it with two individuals whom he believed were operating the false claim schemes, the general manager of his group and his functional supervisor, but his concerns were not resolved.

Bagley was notified in early 1993 that he was going to be laid off as a result

of a reorganization at TRW. Bagley was ultimately laid off in August of 1993. When he left TRW, Bagley took documents that pertained to the false claims issue. After he was laid off, Bagley looked for employment for about a year. Bagley has had no other employment since being laid off by TRW. Until 2003, Bagley's sources of income after being laid off were a retirement pension from TRW and some savings.

In mid-1994, Bagley sued TRW for wrongful employment termination. Bagley ultimately lost the wrongful termination lawsuit against TRW.

In June 1994, Bagley met with Tuttle & Taylor to discuss filing a FCA lawsuit. He met Michael Bierman ("Bierman") for the first time. Bierman was an experienced attorney who had prior FCA litigation experience. Bagley retained Tuttle and Taylor to represent Bagley for the FCA suits on October 1, 1994. Because of Bagley's role in falsely certifying TRW's "indirect" expense summaries which were submitted to the government, Bagley retained Tuttle & Taylor in part to help him seek immunity for the possibility that he could be charged criminally in submitting false documents to the United States.

Prior to filing any FCA suits, Bagley spent over 200 hours in furtherance of the FCA prosecution activity, including his attendance at numerous meeting and submitted written representations to Bierman. Bagley filed two lawsuits on behalf of the United States under the FCA against TRW for false claims. Bagley's FCA suits involved claims by TRW for the recovery of "indirect" costs charged under government contracts. The essence of Bagley's FCA lawsuits was that TRW allocated certain costs to the government as indirect expenses when those costs were not properly pooled as indirect costs and not allowable as charges to the government.

Bagley filed the first FCA lawsuit on behalf of himself as relator and on behalf of the United States on November 16, 1994. This complaint asserted eight claims against TRW. On June 21, 1995, approximately seven months after the first

FCA complaint was filed, Bagley as a relator filed a second FCA complaint against TRW. The second FCA suit, which Bagley continued to pursue after the Government declined to intervene, had amounts of damages that were double the damage amounts in the first FCA suit. Bagley exerted diligent efforts to convince the Government to intervene in the FCA suits in order to reach a successful conclusion.

By 1996, Bagley hired a second law firm that specialized in FCA suits, Phillips and Cohen. Bierman subsequently became a partner in the law firm Luce, Forward, Hamilton & Scripps ("Luce Forward") and Luce Forward continued representing Bagley in the FCA suits until 2003.

In 1998, the Federal government intervened on two of the eight claims alleged in the first FCA suit, and Bagley dismissed the remaining claims in that suit. Bagley continued to pursue the second FCA suit after the Government initially declined to intervene, based upon his belief that he would be able to find favorable evidence which he knew existed and the identity of those engineers who had knowledge of such evidence. Bagley spent considerable time in "structuring the evidence" in the second lawsuit in order to convince the Government to intervene. The federal government intervened on the second FCA suit in 2000.

From June 1994 through the settlement of the FCA claims in 2003, Bagley provided information to his attorneys which he thought was important to the FCA suits and which they needed to know in order to effectively prosecute them. During the 1994 to 2003 time period, Bagley exclusively worked on his FCA prosecution activity, and was not otherwise employed.

Bagley maintained a contemporaneous log of hours he worked in relation to the litigation of the *qui tam* actions. The log started in June of 1994, when Bagley was assisting his attorneys in preparing the first FCA complaint. Bagley spent approximately 5,963 hours on his FCA activity. The hours spent by Bagley in the FCA prosecution activity varied from year to year based on the present demands of

the litigation. Bagley's counsel spent 21,054 hours prosecuting the FCA suits.

Bagley attended meetings with his counsel and the Federal government's counsel. He attended monthly litigation meetings conducted by AUSA David Long, and he also attended 40-50 meetings with the Defense Contract Audit Agency ("DCAA") to reach a consensus on the financial damages to the Government. Bagley was deposed during the FCA litigation. Bagley provided to his private counsel his written summaries of information regarding TRW's false claims.

Bagley's attorneys would prepare documents and Bagley made comments on draft documents prepared by his attorneys, and Bagley spent a lot of time looking through TRW documents. Bagley was able to help identify key documents of TRW because he "worked at TRW and the documents of interest were documents that [he] knew existed from having looked at them and [he] knew where they were and [he] knew whose possession they were in." Because he "had worked at TRW in association with those individuals," Bagley knew and identified individuals at TRW who had knowledge of a certain false claim.

Bagley stayed involved with the prosecution of the FCA claims by his private counsel team because "they weren't accountants and hadn't spent 25 years working with TRW and didn't have an in-depth understanding of TRW's accounting system or the people or the products or anything about the company which was necessary to understand how the frauds occurred and where the evidence was."

Bagley was helpful to his attorneys in the following ways.

a. First, Bagley had a fairly extensive knowledge of most of the facts that underlay the FCA claims because "he was either there or he knew what happened if he wasn't there." He spent a significant amount of time presenting the evidence and issues to his attorneys in order to help them understand various elements of the FCA suits and thereby improve the probability of success.

b. Second, he had an encyclopedic knowledge of the federal acquisition

regulations ("FAR") and of the accounting rules that related to the cost pools. Bierman found this to be very helpful, as he was not an expert in that area and Bagley was able to assist him particularly by providing the broader context of the regulations and rules, i.e. if the attorneys were interpreting one particular rule and Bagley was able to point out if there was another rule that would also play into the analysis.

c. Third, he had a good knowledge of the pricing provisions of the government contracts. Bierman found this helpful because that information was not all compiled in one place, so Bagley's understanding of the pricing procedures and claims settlement procedures was very helpful.

d. Fourth, Bagley understood what could be characterized, according to Bierman, as the "code" used by TRW employees when they wrote various memoranda. He also knew where to look specifically for documents that would memorialize decisions made by TRW, and how to determine whether a memorandum which might, on its face, look innocuous was, in fact, TRW's recording of an improper cost accounting decision.

Further, Bagley, along with Private Counsel, substantiated the false claims allegations by obtaining documentary evidence that did so, and then interviewing or deposing the involved engineers to confirm the types of activities they were engaging in. Bierman found Bagley's familiarity with the witnesses to be very helpful when deposing them.

There were times when Bagley felt that Private Counsel did not understand the issues. In response, Bagley provided the specific information they needed to understand what the government regulations required. He also interpreted those regulations for them and supported his comments through case law.

Bagley drafted and/or edited at least 73 documents in furtherance of the FCA

litigation activity. Bagley also played a primary role with respect to calculating damages and, to that end, attended 40 to 50 meetings with the DCAA between 1997 and 2003. He also spent substantial hours doing his own damage calculations.

Bagley was involved in all aspects of gathering documentary evidence against TRW. He reviewed the extensive production of documents received from TRW, and he structured the evidence found in those documents to put together the false claim allegations against TRW.

Michael Pace, a United States Air Force Investigator, requested that Bagley review TRW's document production. Between 1995 and early 1997, Bagley reviewed the contents of approximately 212 to 218 boxes of documents produced by TRW between mid-1995 and early 1997. In 1998, Bagley reviewed an additional 36 boxes produced by TRW with respect to the second FCA suit. The government helped Bagley in his document review by making copies of certain documents Bagley thought were of exceptional importance.

Bagley had to be involved throughout the entire FCA litigation. Bagley testified: "Because these false claims were allegations of accounting fraud and I was the only person on the prosecution team that understood all aspects of the accounting fraud. And I possessed information that was necessary to the prosecution that nobody else on the team had." There were times during the prosecution of the FCA suits when Bierman would request Bagley to perform certain services to assist in the litigation and Bagley was always responsive. Bagley was the primary source for the facts and for much of the accounting, and his actions made the two cases much stronger for the government. For example, there were times when Bagley's explanations regarding the facts were integrated into documents Bierman provided to the court and/or the Government.

Bagley performed these services "in order to successfully prosecute the claims so that [he] would receive an award." The FCA prosecution activity was a very physically and emotionally grueling experience for Bagley. Bagley did not

consider the FCA prosecution activity to be a hobby. The FCA litigation had a negative impact on his life in that his former TRW colleagues had been directed by TRW to avoid interacting with him. Bagley considered himself to be in a trade or business, with his occupation being a "Private Attorney General." On his originally filed 2003 IRS Form 1040, Bagley identified his occupation as "Private Attorney General" and he issued IRS Forms 1099-MISC to his attorneys for legal fees he paid to them and filed these IRS Forms 1099-MISC with the Internal Revenue Service ("IRS").

Bagley never filed any business tax returns for his FCA relator activity other than his second amended 2003 federal return. Bagley never filed any business registration or notice anywhere with a city or the state. Bagley did not do any advertising of his business. Bagley did not keep accounting books and records for his qui tam relator activity.

Bagley did not keep track of expenses that he personally incurred in the FCA lawsuits. Bagley's expenses in the qui tam law suit were parking fees, gasoline, and cost of paper. Bagley's attorneys in the FCA suits advanced a total of $527,766 in costs. Bagley did not have to pay his FCA lawsuit filing fee.

Bagley's attorneys explained to him that he could be liable to TRW for filing a frivolous lawsuit if he could not substantiate the allegations, and that, in the FCA lawsuit, he could be responsible to TRW for its attorneys' fees and their expenses and costs. However, Bagley and his attorneys agreed in their best judgment that the qui tam lawsuit was meritorious.

In July of 2002, Bagley and his *qui tam* attorneys (Luce Forward) entered into an amended retainer agreement in anticipation of settlement or resolution of the *qui tam* actions. Under this agreement, Bagley was not liable or required to pay any costs or attorneys' fees or other expenses incurred by the law firms in prosecuting the qui tam action unless and until Bagley received a reward.

Some of the provisions in the amended fee agreement had to do with

indemnification against liability for federal taxes which may arise if the Statutory Fee award was determined to be Bagley's income. At the time the amended fee agreement was entered into, Bagley had researched the taxation of his award and the attorney's fees that were associated with it and understood there was case law to support that the Statutory Fee award was taxable income. Bagley realized that, if the Statutory Fee award was paid and treated as income to him, his taxes would go up by several million dollars. The amended retainer agreement contained an indemnity agreement from his *qui tam* counsel to pay the additional tax due to the inclusion of the Statutory Fee award as income if certain conditions were met.

The amended retainer agreement does not refer at all to the possibility that the statutory fee award may also be deducted as a trade or business. Bagley's asserted "trade or business" never came up in the negotiation of the amended retainer agreement. Bagley never sent a letter to Luce Forward or his other FCA counsel telling them of his belief that his FCA activities were a trade or business. Bagley claims he researched the issue, but did not find any case law in which an FCA award was treated as trade or business income.

To comply with the indemnity agreement, Bagley was required to file his original 2003 income tax return that his *qui tam* attorneys (Luce Forward) directed him to file, and his original return was filed per their direction.

In June 2003, Northrop Grumman Corp. ("Northrop"), the successor to TRW, agreed to pay the United States $111.2 million to settle the FCA allegations in the two FCA suits filed by Bagley. In 2003, the United States Department of Justice awarded Bagley a FCA *qui tam* award in the amount of $27,244,000. The United States Department of Justice issued Bagley a 2003 Form 1099-MISC reporting the $27,244,000 FCA *qui tam* award in Box 3, *Other Income*. In 2003, Bagley paid his Private Counsel (Phillips & Cohen LLP and Luce, Forward, Hamilton, and Scripps LLP) $8,990,520 as a contingency fee. Prior to this payment, the only attorneys' fees paid by Bagley was the amount of $3,500 to Tuttle & Taylor, to represent him

in seeking immunity from prosecution from the Department of Justice for his own role in TRW's false claims when he was a TRW employee.

In September 2003, Northrop wire transferred $9,407,295 to Phillips & Cohen, LLP as payment of the statutory attorneys' fee award expenses required by 31 U.S.C. § 3730(d) (the "Statutory Fee"). Northrop issued Bagley a 2003 Form 1099-MISC reporting the $9,407,295 Statutory Fee in Box 14, *Gross proceeds paid to an attorney*.

Bagley submitted to Luce Forward for its review three possible 2003 federal income tax returns for the original return to Luce Forward for its review, none of which included a Schedule C form for treatment of the *qui tam* income. Luce Forward directed Bagley to file an original 2003 return, 2003 Form 1040, *U.S. Individual Income Tax Return*, which reported his qui tam award as "other income" and omitted the statutory fee award from his income.

On or about October 15, 2004, Bagley filed his 2003 IRS Form 1040, *U.S. Individual Income Tax Return*. That return claimed the $27,244,000 qui tam award as ordinary income and $9,070,520 of attorney's fees as a Schedule A deduction, but failed to report the $8,990,520 of income from the Statuory Fee Award. Bagley had concerns about filing the 2003 return as directed by Luce Forward, because he believed the Statutory Fee award had to be included in income.

On or about May 10, 2005, Bagley filed a 2003 IRS Form 1040X, *Amended U.S. Individual Income Tax Return*. On the Form 8275, *Disclosure Statement*, filed with the amended return, it was explained that the return was being amended to include the statutory attorneys' fees in income. Bagley's original 2003 income tax return and first amended 2003 return were both signed under penalty of perjury, and Bagley read the jurat clause on both the returns when he signed them.

On or about August 3, 2007, Bagley filed a second 2003 IRS Form 1040X, *Amended U.S. Individual Income Tax Return*.

a. On Bagley's second 2003 IRS Form 1040X, he reported

$36,651,295 as gross income—comprised of the $27,244,000 FCA Award and $9,407,295 Statutory fee—on a form Schedule C, *Profit or Loss from Business*.

b. Of the $36,651,295 gross income Bagley reported on the form Schedule C, as included in his second amended 2003 tax return, he paid a total of $18,477,815 to his attorneys. Those legal fees were deducted on a Schedule C, Profit or Loss From Business.

For the 2003 tax year, Bagley paid federal income taxes and interest totaling $10,363,241. On December 8, 2009, the IRS denied Bagley's claim for refund in his second 2003 IRS Form 1040X.

The court makes the following credibility findings: The court found Bierman and Bagley to be credible witnesses. The government has noted that Bagley signed tax returns under penalty of perjury while having concerns that they did not accurately categorize the statutory fee or the other litigation fees and asks this court to draw from it a negative inference regarding Bagley's credibility and truth-telling. The court declines to do so, as the tax issues in this case are not clear-cut, and Bagley's uncertainty and confusion about his tax obligations should not be construed as obfuscation or lying.

If any of these findings of fact are more properly conclusions of law, they are hereby incorporated in that part entitled "Conclusions of Law."

CONCLUSIONS OF LAW

I. JURISDICTION

The court has jurisdiction over this action pursuant to 28 U.S.C. § 1346(a)(1) and 26 U.S.C. § 7422(a). Venue in this court is proper under 28 U.S.C. § 1402(a)(1) since Bagley resides within this judicial district. All parties admit the facts requisite to federal jurisdiction and venue.

II. BURDEN OF PROOF

"A taxpayer seeking a tax refund bears the burden of proving that the

assessment was incorrect and proving the correct amount of the tax owed." *Ray v. United States*, 762 F.2d 1361, 1362 (9th Cir.1985) (citing *Helvering v. Taylor*, 293 U.S. 507, 515, 55 S.Ct. 287, 291 (1935)). The burden of proving that a deduction qualifies as an ordinary and necessary expense of a trade or business rests on the taxpayer. *See INDOPCO, Inc. v. CIR*, 503 U.S. 79, 84-85 (1992).

III. FALSE CLAIMS ACT

The FCA establishes liability for "[a]ny person" who "knowingly presents, or causes to be presented, to an officer or employee of the United States Government . . . a false or fraudulent claim for payment or approval." *Vermont ANR v. United States ex rel. Stevens*, 529 U.S. 765 (2000) (quoting 31 U.S.C. 3729(a)). The defendant is liable for up to treble damages and a civil penalty of up to $10,000 per claim. 31 U.S.C. § 3729(a). The Act authorizes both the Attorney General and private persons to bring civil actions to enforce the Act. 31 U.S.C. § 3730. An action brought by a private person under Section 3730(b) of the FCA is termed a "qui tam" suit, and the person who brings such an action is referred to as a "relator" or "informer." *Kelly*, 9 F.3d at 761. Various other terms have also been used by courts to describe the role of the relator: "a private prosecutor," or a "private attorney general." *See Kelly*, 9 F.3d at 760; *see also United States ex rel. Milam v. Univ. of Texas*, 961 F.2d 46, 49 (4th Cir. 1992) ("A *qui tam* relator is essentially a self-appointed private attorney general, and his recovery is analogous to a lawyer's contingent fee.").

The FCA is the government's "primary litigative tool for combating fraud" against the federal government." *U.S. ex rel. Kelly v. Boeing Co.*, 9 F.3d 743, 745 (9th Cir. 1993) (quoting Senate Judiciary Committee, False Claims Amendments Act of 1986, S.Rep. No. 345, 99th Cong. 2d Sess. 2 (1986), reprinted in 1986 U.S.C.C.A.N. 5266). Congress amended the FCA in 1986 to increase the financial and other incentives for private individuals to bring suits under the Act and thereby to enlist the aid of the citizenry in combating the rising problem of "sophisticated

and widespread fraud." *Id.* (citing S.Rep. No. 345 at 2, 23-24, reprinted in 1986 U.S.C.C.A.N. at 5267, 5288-89). The legislative history indicates that Congress sought to encourage more private enforcement of the FCA because "detecting fraud is usually very difficult without the cooperation of individuals who are either close observers or otherwise involved in the fraudulent activity." *Id.* (citing S.Rep. No. 345 at 4, reprinted in 1986 U.S.C.C.A.N. at 5269). Further, Congress was also concerned with the "lack of resources on the part of Federal enforcement agencies" that often leaves unaddressed "allegations that perhaps could develop into very significant cases." *United States ex rel. Green v. Northrop Corp.*, 59 F.3d 953, 963 (9th Cir. 1995) (citing S. Rep. No. 345, 99th Cong., 2d Sess. 2-3 (1986), reprinted in 1986 U.S.C.C.A.N. 5266, 5272).

The financial incentives for relators under the FCA are scaled depending on the contribution of the relator. As stated by the Ninth Circuit in *Green*, "[a] relator who properly brings a claim will generally receive a share of the recovery as well as eligibility for attorneys' fees and costs. This is true even if the government decides to intervene and prosecute the action itself, or elects to pursue its claim in an administrative proceeding. The right to recovery clearly exists primarily to give relators incentives to bring claims. Moreover, the extent of the recovery is tied to the importance of the relator's participation in the action and the relevance of the information brought forward. This demonstrates not only the importance of the incentive effect, but that Congress wished to create the greatest incentives for those relators best able to pursue claims that the government could not, and bring forward information that the government could not obtain." *Green*, 59 F.3d at 963-64. Further, "[p]roviding the relator a right to recover . . . also serves the additional purpose of giving a relator the incentive to 'act as a check that the Government does not neglect evidence, cause undu[e] delay, or drop the false claims case without legitimate reasons.'" *See id.* (quotations and citations omitted). In cases in which the government chooses to prosecute the action, the relator will receive "at least 15

percent but no more than 25 percent of the action or settlement of the claim, depending upon the extent to which the person *substantially contributed* to the prosecution of the claim." 3730(d)(1) (emphasis added).

Bagley received a qui tam award of $27.7 million, which was 24.5% of the FCA Settlement paid by TRW. Bagley's award was very near the highest percentage award possible for a relator in a qui tam action in which the government has intervened. From that award, the court concludes that Bagley made a very substantial contribution to the prosecution of the claim and that the government itself found Bagley's contribution- both the information he provided and also the filing of and dogged pursuit of his two FCA lawsuits- to be meaningful.

The government points out that Bagley did not immediately disclose to it the fraudulent claims when he first found out about them, that he only did so after not finding any further employment, that he removed documents from TRW in violation of his employment contract, and that he sought immunity from criminal prosecution by the federal government prior to litigating the FCA lawsuit. The court does not find these facts overall diminish the substantial contribution made by Bagley to the FCA lawsuits. In fact, Congress was well-aware that it needed to rely on people who may have been involved in the fraudulent claims, to be able to uncover the schemes. *Kelly v. Boeing Co.*, 9 F.3d at 745 (citing S.Rep. No. 345 at 4, reprinted in 1986 U.S.C.C.A.N. at 5269) ("detecting fraud is usually very difficult without the cooperation of individuals who are either close observers or otherwise involved in the fraudulent activity").

IV. SECTION 162 TRADE OR BUSINESS DEDUCTION

The issue in this case is whether Bagley must include his income from the *qui tam* lawsuits as "other income" on his 2003 federal tax return and deduct the attorneys fees on Schedule A, as he did on his first amended return, or whether he can properly report the *qui tam* award on Schedule C and deduct his attorney fees as ordinary and necessary business expenses, as he did in his second amended return.

26 U.S.C. § 162(a) provides a deduction for all "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." Therefore, in order for Bagley to succeed on his claims, he must establish that his attorneys' fees qualified as "ordinary and necessary expenses" paid or incurred during the taxable year in carrying on a "trade or business." *See id.* While there is a wealth of case law concerning what constitutes a trade or business under Section 162(a), and also whether litigation fees are appropriately considered a business expense, the precise issue confronted here regarding the characterization of a *qui tam* relator's award and litigation fees he or she incurred while pursuing that claim under Section 162(a) appears to be one of first impression.

Before the court analyzes whether Bagley has shown that his activity as a relator in a *qui tam* action is a business and the expenses associated with the lawsuits were ordinary and necessary business expenses, it must first ascertain what