

**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:BR05 – PLR-133842-04

Date:

January 03, 2005

In Re:

Att'n:

**LEGEND:**

Company =

Company A =

Class Counsel =

Class Representatives =

Class Members (v) =

Court Z =

States:

X =

Y =

Z =

Dates:

1 =

2 =

3 =

Amounts:

\$n =  
\$o =

Dear

This letter responds to your authorized representative's letter and submissions of June 11, 2004, and other correspondence and submissions, in which she requested on your (the Company's) behalf certain rulings regarding the proper federal tax treatment of attorneys' fees paid in connection with the settlement of a certain "opt-out" class action lawsuit (as more fully described below) under sections 61 and 6041 of the Internal Revenue Code (the Code). Specifically, you requested rulings that the attorneys' fees paid pursuant to the "Settlement Agreement" to "Class Counsel" are not includable in the gross income of the "Class Representatives" and "Class Members" (as more fully described below) under section 61 of the Code, and therefore are not subject to information reporting to such "Class Members" and "Class Representatives" under section 6041 of the Code. We are pleased to address your concerns.

## FACTS

The Company is a limited liability company organized under the laws of State X, with principal offices located in State Y. The Company is a subsidiary of Company A, and operates retail stores in a number of states, including State Z.

On Date 2, a class action complaint was filed against Company in State Court Z by Law Firms M and N ("Class Counsel"), on behalf of certain plaintiffs, including Plaintiffs A, B, C, and D ("Class Representatives"), and other similarly situated claimants. The complaint sought recoveries on a number of causes of action, as well as civil penalties, injunctive relief, costs, and attorneys' fees.

On Date 1, prior to filing the class action complaint referred to above, each of the Class Representatives had entered into certain retainer and/or contingency fee arrangements with Class Counsel respecting the subject litigation. The agreements provided, however, that if the subject action was certified by the Court as a "class action," Class Counsel would instead be reimbursed for fees and costs under the "common fund doctrine" from any class-wide monetary settlement. Only in the event the action was not certified as a class action suit, would the separate fee considerations apply.

On Date 3, the Court provisionally certified the class for settlement purposes as an "opt-out" class action lawsuit, the settlement class ("Class Members") of which consisted of all y individuals. None of the Class Members, other than the Class Representatives discussed, have entered into any agreement with Class Counsel respecting payment of any attorneys' fees. Class Counsel will be compensated with respect to all Class Members, including Class Representatives, from the general Settlement Fund under the common fund doctrine.

After extensive negotiations between Company and Class Counsel, the parties have entered into a “Settlement Agreement” resolving and discharging all disputes and claims arising from and related to the subject class action lawsuit. Under the terms of the Settlement Agreement, the Company will pay a total of \$n (subject to a credit against this amount for any opt-outs) (the “Settlement Fund”), plus certain amounts for taxes and the costs of administering the settlement. Payments from the Settlement Fund will be made for certain costs, services, claimant distributions, and Class Counsel attorneys’ fees in the amount of \$o. Appropriate Forms W-2 and 1099s will be issued by Company with respect to compensatory payments, including a Form 1099 to the Class Counsel reporting the payment of \$o attorneys’ fees.

The question presented in this letter ruling request is whether the Class Members are required to take into income their pro-rata share of the attorneys’ fees paid to Class Counsel under the Settlement Agreement, and whether information reporting respecting such payments is required under section 6041 of the Code.

## LAW & ANALYSIS

### *Gross Income Defined*

Section 61 provides generally that, except as otherwise provided by law, gross income includes all income from whatever source derived. The concept of gross income encompasses accessions to wealth, clearly realized, over which taxpayers have complete dominion. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426 (1955); 1955-1 C.B. 207.

When a payment is made to satisfy the obligation of a taxpayer to a third party, the amount of the payment is generally includible in the taxpayer’s gross income. *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929). Even though the taxpayer never actually receives such payment, he receives the benefit of the payment, and the amount is therefore gross income to him or her. Under the rationale of *Old Colony Trust*, a prevailing litigant must generally recognize gross income when another party pays attorneys’ fees for which the litigant is liable.

Where a taxpayer may receive a benefit of litigation but is not liable for payment of attorneys’ fees incurred in connection with such litigation, a different result may obtain, e.g., certain opt-out class action lawsuits where no express contractual liability for a fee exists between the class member and litigating counsel. In general, attorneys’ fees awarded in opt-out class action lawsuits, such as the instant case, are not includible in a class member’s gross income if the class claimant does not have a separate contingency fee or retainer agreement with counsel.

In Rev. Rul. 80-364, 1980-2 C.B. 294 (Situation 3), a union filed claims on behalf of its members against a company due to a breach of a collective bargaining agreement. Subsequently, the union and the company entered into a settlement

agreement, later approved by a federal district court, that provided that the company would pay the union 40x dollars in full settlement of all claims. The union paid 6x dollars of the settlement for attorney's fees and returned 34x dollars to the employees for back pay owed to them. The ruling concluded that the portion of the settlement paid by the union for attorney's fees was a reimbursement for expenses incurred *by the union* and was not includible in the gross income of the union members.

In the instant case, attorneys' fees will not be awarded or paid to Class Counsel pursuant to any specific fee or retainer arrangement between such counsel and the Class Members, including the Class Representatives. Rather, the attorneys' fees will be awarded by the court having jurisdiction over the action under the "common fund doctrine," from the class-wide settlement fund. Because the litigation was certified a class-action lawsuit, no separate agreements remained or became operative, and no amounts of attorneys' fees will be paid pursuant to any separate contingency fee or retainer agreement with a Class Member or Class Representative. Thus, the payment of attorney's fees to Class Counsel from the Settlement Fund is similar to Situation 3 in Rev. Rul. 80-364.

We conclude therefore that the amounts paid pursuant to the Settlement Agreement for attorneys' fees for Class Counsel are not income to the Class Members or Class Representatives in the instant circumstances. Our conclusion that the attorneys' fees paid by the Company pursuant to the Settlement Agreement are not income to the claimants herein is specific to the facts of this case. See *Cf. Sinyard v. Commissioner*, T.C.M. 1998-264, *aff'd*, 268 F.3d 756 (9th Cir. 2001), *cert. denied sub nom, Sinyard v. Rossotti*, 122 S.Ct. 2357 (2002), *Fredrickson v. Commissioner*, T.C. Memo 1997-125, *aff'd* in unpub. opinion, 97- 71051 (9th Cir. 1998).

### *Information Reporting Requirements*

Section 6041(a) provides in part that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$ 600 or more in any taxable year, shall render a true and accurate return to the Secretary.

The word "income" as used in section 6041 is not defined by statute or regulation; however, its appearance in the phrase "fixed or determinable gains, profits, and income" indicates that what is referred to is "gross income," and not the gross

amount paid. Thus, section 6041 requires the Company to report only those payments in excess of \$600 includible in the Class Members' gross income.

In this case, the amounts paid from Settlement Fund to Class Counsel for attorneys' fees are not income to the Class Members or the Class Representatives. Because "income" under section 6041 of the Code is interpreted to mean only income includible in gross income under section 61, the payments of attorney fees are not subject to information reporting to any Class Member, including any Class Representative, under section 6041.

## CONCLUSIONS

Based on the facts and information submitted and the representations made, the following rulings are issued:

- (1) Attorneys' fees paid pursuant to the "Settlement Agreement" to "Class Counsel" are not includible in the "Class Representatives'" or "Class Members'" gross incomes under section 61 of the Code; and
- (2) Because the attorneys' fees do not constitute gross income to the "Class Representatives" or "Class Members" under section 61 of the Code, the attorneys' fees are not subject to information reporting to the Class Members, including the Class Representatives, under section 6041 of the Code.

Final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked by adoption of final regulations, to the extent the regulations are inconsistent with any conclusions in this ruling. See section 12.04 of Rev. Proc. 2004-1, 2004-1 I.R.B. 1. However, when the criteria in section 12.06 of Rev. Proc. 2004-1 are satisfied, a ruling is not revoked or modified retroactively, except in rare or unusual circumstances.

This letter ruling is based on facts and representations provided by the Company and its authorized representatives, and is limited to the matters specifically addressed. No opinion is expressed as to the tax treatment of the transactions considered herein under the provisions of any other sections of the Code or regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, such transactions which are not specifically addressed herein.

Because it could help resolve federal tax issues, a copy of this letter should be maintained with the Company's permanent records.

Pursuant to a power of attorney on file with this office, copies of this letter ruling are being sent to your authorized representative.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Sincerely yours,

/s/ William A. Jackson

William A. Jackson  
Chief, Branch 5  
Associate Chief Counsel  
(Income Tax & Accounting)

Enclosures:

Copy of this letter

Copy for section 6110 purposes