

Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

In Re:

Refer Reply To:

CC:ITA:B4 – PLR-101062-04

Date: July 20, 2004

X	=	
B	=	
C	=	
D	=	
E	=	
F	=	
G	=	
H	=	
J	=	
K	=	
L	=	
M	=	
Y	=	
Z	=	

Dear :

This is in reply to your letter and submissions, and other correspondence, in which you request a ruling regarding the proper federal income tax treatment of certain judgment or settlement proceeds attributable to assigned claims.

FACTS

The representations and information submitted indicate that X is a plaintiff in a legal proceeding pending in the C, entitled D. X has asserted various claims including L claims under E and F, and Z law claims for G and H. X requests J as remedies for these and other claims. There are no settlement negotiations underway and X strongly desires to secure a trial court judgment. The trial has ended but the trial court has not issued its opinion.

X is a corporation organized under the laws of M. B is an organization described in § 501(c)(3) of the Internal Revenue Code that is exempt from tax under § 501(a). B is also a private foundation under § 509(a). X is the principal contributor to B.

X proposes to assign gratuitously 50% of its rights, title, and interest, in claims E, F, G, and H to B subject to certain conditions precedent (“Assignment”). At this time, it is contemplated that the laws of Y will govern the Assignment.

The Assignment becomes effective after X, as assignor, and B, as assignee, execute the Assignment and the following two conditions are satisfied:

1) Either (a) a court of appropriate jurisdiction issues a judgment disposing of all claims for relief without an award of K (or if the judgment includes an award of K, X waives the condition that the award must not include K),¹ provided that a period of time exists for appealing the judgment or (b) X initiates settlement negotiations or responds affirmatively to a request to initiate settlement negotiations; and

2) Prior to either the expiration for the appeals period for a judgment, or the date of a final settlement, the IRS issues a favorable private letter ruling that the assigned portion of the claims are not taxable to X.

X and B expressly agree in the Assignment that X, in its sole judgment, may pursue the litigation, handle any and all settlement discussions, and take any actions necessary to enforce and collect on an award of money damages reduced to a final judgment. The Assignment also provides that X will pay all attorneys’ fees and costs incurred in connection with the legal proceeding and is entitled to any fees and costs awarded. The Assignment does not entitle B to attorneys’ fees, costs, or expenses, if awarded. X represents that the E, F, G, and H claims are assignable under applicable L and Y law (as well as Z law, if the parties subsequently decide that Z law rather than Y law should govern the Assignment). X also represents that the Assignment is valid and enforceable. Once the Assignment is executed, the timing of the transfer is dependent upon the fulfillment of the conditions enumerated above. If, for any reason, the conditions are not met, the Assignment will never become effective.

¹ K claims are not assignable under Y law. See

X also represents that, assuming satisfaction of the conditions precedent contained in the Assignment, B may be joined as a party to D. The decision to join B as an additional party to D or to an appeal of D is beyond X's control and would depend upon certain variables including the nature of the C's ultimate ruling and whether the C determined that joinder of B as a party is appropriate.

LAW AND ANALYSIS

Section 61 provides that, except as otherwise provided in subtitle A (relating to income taxes), gross income means all income from whatever source derived.

In general, under the anticipatory assignment of income doctrine, a taxpayer who earns or otherwise creates a right to receive income will be taxed on any gain realized from it, if the taxpayer has the right to receive the income or if, based on the realities and substance of the events, the receipt of the income is practically certain to occur (*i.e.*, whether the right basically has become a fixed right), even if the taxpayer transfers the right before receiving the income. *Ferguson v. Commissioner*, 174 F.3d 997 (9th Cir. 1999); *Jones v. United States*, 531 F.2d 1343, 1346 (6th Cir. 1976); *Kinsey v. Commissioner*, 477 F.2d 1058, 1063 (2d Cir. 1973); *Hudspeth v. United States*, 471 F.2d 275, 280 (8th Cir. 1972); *Estate of Applestein v. Commissioner*, 80 T.C. 331 (1983); *Lucas v. Earl*, 281 U.S. 111 (1930). In contrast, the mere anticipation or expectation of the receipt of income is insufficient to conclude that a fixed right to income exists. *S.C. Johnson & Son, Inc. v. Commissioner*, 63 T.C. 778, 787-88 (1975).

With respect to the assignment of claims in litigation, a review of the case law shows that anticipatory assignment of income principles require the transferee to include the proceeds of the claim in gross income where recovery of the transferred claims is certain at the time of transfer, but not where recovery of such claim is doubtful or contingent at the time of transfer. In *Doyle v. Commissioner*, 147 F.2d 769 (4th Cir. 1945), a taxpayer assigned 60 percent of a claim that he owned to his wife and children after the Court of Claims denied application for a new trial and the Supreme Court of the United States denied taxpayer's petition for writ of certiorari. The government argued that, after the denial of certiorari and before the transfer to his wife and children, the gain that the taxpayer expected to receive was "practically assured" and thus its transfer resulted in an anticipatory assignment of income. *Doyle*, 147 F.2d at 772. The court, agreeing with the government's argument, held that the taxpayer was in receipt of the profits on his purchase of the interest in the lawsuit because, at the time he made the gifts of his interest in the lawsuit, such profits "had already been rendered *certain* by the judgment of the Court of Claims and denial of certiorari by the Supreme Court." *Doyle*, 147 F.2d at 773 (Emphasis added.)

Like *Doyle*, *Cold Metal Process Co. v. Commissioner*, 247 F.2d 864 (6th Cir. 1957), *rev'g*, 25 T.C. 1333 (1956), follows the view that a taxpayer's right to income on a judgment is not earned or does not ripen until all appeals with respect to the judgment have been exhausted. *Cold Metal* demonstrates the doubtful and contingent nature of a

lower court judgment during the time an opposing party is prosecuting appeals. Citing to *Harrison v. Shaffner*, 312 U.S. 579 (1941), the court stated, “[T]he rule applicable to an assignment of income applies when the assignor is entitled at the time of the assignment to receive the income at a future date and is vested with such a right.” *Cold Metal*, 247 F.2d at 873. In *Cold Metal*, the court held that, notwithstanding a district court’s opinion for the taxpayer in a cancellation suit, as of the end of that year it had only a “contingent right to income ... payable, if at all, at some indefinite time in the future in an indeterminate amount, with respect to which the assignor had no voice or control whatsoever ...” *Cold Metal*, 247 F.2d at 873. Thus, *Cold Metal*’s assignment did not result in an assignment of income.

Similarly, in *Wellhouse v. Tomlinson*, 197 F. Supp. 739 (S.D. Fla.1961), the court found that a transferor was not taxable on the interest portion of a note because there were doubts as to whether there ever would be payment by the debtor, and because the creditor divested himself of all rights to the note in a year prior to the year of payment. In reaching this conclusion, the court placed considerable emphasis on the fact that there were certain legal defenses available to the estate of the debtor, even though it was doubtful whether these defenses could ever be raised because of the possibility of waiver on the part of the debtor’s estate. In this regard, the court stated, “The point is, however, that there were real *legal doubts* concerning the time and extent of collectibility of the note at the time of the assignment.” *Wellhouse*, 197 F. Supp. at 742. (Emphasis added.)

In *Jones v. Commissioner*, 306 F.2d 292 (5th Cir. 1962), *rev’g*, T.C.M. 1960-115, an insolvent taxpayer-subcontractor made a claim in 1944 through the general contractor against the United States for additional compensation for work done. In February 1953, the taxpayer assigned the claim to a related corporation for \$10,000 and the corporation’s agreement to pay the taxpayer’s 1948-1950 tax deficiencies. Thereafter, the corporation assumed the costs of the action. In July 1953, the Court of Claims decided the claim favorably to the taxpayer, which decision became final in October 1953. In April 1954, the taxpayer received an award of \$259,936 (net of attorney’s fees of \$79,741) which he endorsed over to the corporation pursuant to the assignment. The court concluded that the taxpayer was not taxable on the award. In so holding the court noted that (1) the claim was *contingent and doubtful* when it was assigned, (2) no gift was involved, (3) the assignment was made prior to the year the income was received, and (4) the assignment arose out of the exercise of a legitimate business purpose. (Emphasis added.)

In *Schulze v. Commissioner*, T.C.M. 1983-263, a taxpayer sued his former law partnership for damages. Subsequently taxpayer and his wife divorced and agreed to divide their assets equally, including taxpayer’s claim against the partnership. The value of the claim was *not determinable* at the time of the property division. Subsequently, taxpayer recovered on his claim and paid a portion to his former spouse. Following, *Jones, supra*, the Tax Court held that taxpayer was not required to include in his gross income the portion of the award paid to his former spouse because: (1) at the

time of the assignment, recovery on the claim was uncertain; (2) the recovery did not occur for more than a year after the assignment of the claim; (3) the assignment did not involve a gift or gratuity, and (4) the assignment was made for a legitimate non-tax purpose. The court also noted that the outcome of a lawsuit is rarely, if ever, certain or free of doubt. Since the assignment was made before the arbitrator's decision, and the arbitrator's decision appears to have been final, this opinion is not inconsistent with the principle that income arising from a judgment is contingent until the final decision in a suit is rendered.

In *Beauty Acquisition Corp. v. Commissioner*, T.C.M. 1995-87, Beauty Acquisition Corporation (BAC) entered into an asset purchase agreement with Revlon. Shortly thereafter, a dispute arose over the terms of the contract, and BAC sued Revlon. In its complaint, BAC sought specific performance of the contract. Representatives of the various parties exchanged drafts of settlement agreements from May 1986 to September 1986. On September 29, 1986, BAC distributed its claim against Revlon, which was its sole asset, to A&S, an agent for the holders of interest in BAC. On October 2, 1986, BAC formally dissolved. On October 28, 1986, Revlon entered into settlement agreements with BAC's lenders in exchange for settling their claims against Revlon. On December 2, 1986, Revlon and A&S entered into a settlement agreement providing for Revlon to pay \$23,700,000 in exchange for the agreement by A&S to end its litigation with Revlon. On that same day, A&S received the settlement payment from Revlon. The court concluded that the consideration for settlement payments was BAC's agreement to end the litigation against Revlon, and it was not until execution of formal settlement agreements that the right to the settlement payments became fixed. In so holding the court stated, "A dispute is resolved when the parties settle or when liability is finally determined and is not subject to further appeal or contest."

The above-cited line of cases support the proposition that, in general, a transferor who makes an effective transfer of a claim in litigation to a third person prior to the time of the expiration of appeals in the case is not required to include the proceeds of the judgment in income under the assignment of income doctrine because such claims are contingent and doubtful in nature.

Based on the information submitted and representations made, X will assign claims E, F, G, and H to B prior to the expiration of the period for appealing the trial court judgment and the date of a final settlement agreement. Thus, X's assignment to B of the claims E, F, G, and H will occur during the time such claims are contingent and doubtful in nature.

CONCLUSION

Accordingly, based strictly on the information submitted and each of the representations made (including the representations that the assignment of claims E, F, G, and H is effective under L, Y, and Z law, as appropriate, and that the Assignment is valid and enforceable under Y and Z law, as appropriate), and provided that the two conditions to

make the Assignment effective are met, we conclude that judgment or settlement proceeds attributable to the 50% interest in claims E, F, G, and H that are assigned to B under the Assignment will not be includible in X's income. X must include in its income, however, at least that portion of any judgment or settlement proceeds that are used to pay its attorneys fees or that are awarded to it as attorneys' fees.

CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, including § 170.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

In accordance with the Power of Attorney and Declaration of Representative on file in this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter should be attached to any tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter showing the deletions proposed to be made when it is disclosed under § 6110.

Sincerely,

Michael J. Montemurro
Senior Technician Reviewer
Office of Chief Counsel
(Income Tax & Accounting)

Enclosures (2)