

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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PLR-132932-05

Date:

December 01, 2005

### Legend:

Fund =

Court =

Defendant =

State =

Year 1 =

Year 10 =

Year 11 =

Date 1 =

\$ A =

\$ B =

\$ C =

\$ D =

\$ E =

\$ F =

\$ G =

\$ H =

M =

N =

P =

Q =

R =

Dear :

This is in reply to a request for rulings dated June 14, 2005, concerning the establishment of Fund pursuant to an order of settlement approved by the Court in connection with a class action lawsuit brought against Defendant for declaratory and injunctive relief and equitable restitution for alleged violations of the Employment Retirement Income Security Act of 1974 (ERISA), as amended. Specifically, you have requested the following rulings:

1. Fund is a qualified settlement fund described in section 1.468B-1 of the Income Tax Regulations;
2. Fund does not have a reporting obligation under section 6041 of the Internal Revenue Code for distributions made to class members; and
3. Fund does not have a reporting obligation to class members under section 6041 of the Code for amounts paid from Fund for administration costs and attorneys' fees paid to class counsel.

### FACTS

Defendant is a nonprofit corporation located in State engaged in the business of providing insurance coverage for employer-sponsored health and welfare benefit plans for employees. The plans are governed under ERISA, among other federal and state laws.

In Year 1, individual policyholders, participants and beneficiaries in employer-sponsored health and welfare benefit plans, provided and administered by Defendant, filed a lawsuit in the Court against Defendant, alleging, among other things, that Defendant violated ERISA and related plan contractual obligations with covered individuals by causing them to overpay for services provided by Defendant, and/or, by failing to fully reimburse individual policyholders for medical costs and services. The lawsuit was certified as a class action in Year 1 with an estimated M class members.

In Year 10, after several years of pre-trial litigation, the parties to the class action lawsuit agreed to settle the case. On Date 1, the Court entered an order approving the stipulation of settlement, among other things.

The stipulation of settlement provides, in pertinent part, that Defendant will pay a total of \$ A into Fund to be used to settle all claims of the class members. It also provides that costs of administering the settlement and class counsel attorneys' fees will be paid from Fund. After administration costs and attorneys' fees, Fund will have approximately \$ B to distribute to individual class members in accordance with the terms of the stipulation of settlement

The fund administrators estimate that N class members (out of a total of approximately M) will receive cash distributions from the settlement. The fund

administrators used a database provided by Defendant to identify and locate potential claimants, and mailed out P notices to class members at their last known address. The information from Defendant's database also included social security numbers for nearly 99% of potential class members.

The fund administrators estimate that at least two separate cash distributions will be made from Fund to claimants. An initial cash distribution will be sent to the N class members referred to above, to the last known address. No other requirement is necessary to be entitled to receive an initial cash distribution. Since all N class members will automatically be sent initial distributions, and no similar litigation has been initiated by or on behalf of any individual, no actual "opt out" or request for exclusion is necessary as part of the settlement or as an element in the notice to class members.

The initial cash distribution is scheduled to be made in Year 10 (pending the outcome of this ruling). Based on estimates, initial cash distributions to individual claimants will range from as low as \$ C to as high as \$ D, with an average initial cash distribution of \$ E. About Q class members entitled to an initial cash distribution will receive distributions of \$ E or more.

Approximately R of the N class members will be eligible to receive a second cash distribution. To receive a second cash distribution, a claimant must provide a current address and a signature. The second cash distribution likely will be made in Year 11. The fund administrators also estimate that approximately \$ G will be available for the second cash distributions, with an average cash distribution to individual claimants of approximately \$ H.

Fund makes the following additional representations:

1. While individual distribution amounts are calculated from actual claims experience based on data submitted by Defendant to the fund administrators, the fund administrators believe it is unnecessary, impractical, and hopelessly expensive to record (or to calculate) the actual amount of each distribution attributable to any single claim. Individual damage amounts have been both reduced on a percentage basis and pro rated at least twice. A distribution amount therefore could include small segments of damage amounts attributable to dozens, even hundreds, of individual claims, with some being of one type, e.g., drug co-pay, and some of another type, e.g., office visits.

2. The fund administrators believe that no reliable data is available to the parties that can provide any assistance in determining whether the amounts paid by any covered policyholder by way of co-pay or payment for office visit was ever itemized on a tax return or reimbursed from a tax-sheltered plan, such as a cafeteria plan.

## LAW AND ANALYSIS

### 1. Classification of Fund as a Qualified Settlement Fund

Section 468B(g) of the Code provides, in part, that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. Pursuant to the authority of section 468B(g), the Secretary has published sections 1.468B-1 through 1.468B-5 of the regulations regarding qualified settlement funds.

Section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies all three requirements of section 1.468B-1(c). First, section 1.468B-1(c)(1) requires that the fund, account, or trust is established pursuant to an order of, or it is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continued jurisdiction of that governmental authority. Second, section 1.468B-1(c)(2) requires that the fund, account, or trust is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability (i) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980; (ii) arising out of a tort, breach of contract, or violation of law; or (iii) designated by the Commissioner in a revenue ruling or revenue procedure. Third, section 1.468B-1(c)(3) provides that the fund, account, or trust must be a trust under applicable state law, or its assets must be otherwise segregated from other assets of the transferor (and related persons).

Section 1.468B-1(h)(2) provides that if a fund, account, or trust is established to resolve or satisfy claims described in section 1.468B-1(c)(2) as well as other types of claims (i.e., non-allowable claims) arising from the same event or related series of events, the fund is a qualified settlement fund.

Based on the facts represented, the three requirements of section 1.468B-1(c) are satisfied, and as such, Fund is a qualified settlement fund for federal income tax purposes. First, Fund is established pursuant to an order of the Court dated Date 1 over which the Court retains jurisdiction during Fund's complete administration. See § 1.468B-1(c)(1). Second, Fund is established to resolve or satisfy claims brought by the class members against Defendant for damages allegedly sustained as a result of violations of ERISA and other federal and state laws. See § 1.468B-1(c)(2). Third, Fund is maintained in a separate and completely unrelated account in the dominion and control of the fund administrators, and as such, is segregated from the other assets of Defendant. See § 1.468B-1(c)(3). Finally, the fact that other claims will be paid by Fund (e.g., class counsel attorneys' fees) does not prevent Fund from being treated as a qualified settlement fund. See § 1.468B-1(h)(2).

## 2. No Reporting Requirements for Distributions to Class Members

Section 1.468B-2(l)(2)(i) provides that payments and distributions by a qualified settlement fund are subject to the information reporting requirements in sections 6031 through 6060 of the Code.

Section 1.468B-2(l)(2)(ii)(A) provides, in part, that a qualified settlement fund must make information returns for a distribution to a claimant if one or more transferors would have been required to make a return had that transferor made the distribution directly to the claimant.

Section 1.468B-2(l)(2)(ii)(C) provides, in part, that for purposes of section 6041(a), if a qualified settlement fund makes a payment or distribution on behalf of a transferor or a claimant, the fund is deemed to make the payment or distribution to the recipient of that payment or distribution in the course of a trade or business.

Except as otherwise provided, section 6041(a) requires information reporting from all persons engaged in a trade or business who make payments in the course of the trade or business to another person, of rent, salaries, wages, premiums, annuities, compensation, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more. Section 1.6041-1(c) provides that income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. Where the determination of the recipient's gross income inclusion of an amount is based on the knowledge of the recipient's basis and the payer lacks such information, the amount to be paid is not a payment of fixed or determinable amount of gains, profits, or income. See e.g., Rev. Rul. 80-22, 1980-1 C.B. 286 (payment of insurance proceeds not a payment of a fixed or determinable amount of gains, profits, or income, where the determination of the recipients gross income inclusion of the insurance proceeds is based on the knowledge of the recipient's basis and the insurance company lacks such information). In addition, section 111(a) of the Code provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of federal income tax imposed.

Based on the facts represented, Fund does not have an information reporting requirement under section 6041(a) for distributions to class members. The cash distributions from Fund to class members are not payments of rent, salaries, wages, premiums, annuities, compensation, remunerations, and emoluments. Moreover, the cash distributions from Fund to class members are not payments of fixed or determinable gains, profits, and income of \$600 or more. A distribution from Fund may be includible in the gross income of a class member to the extent that the class member derived any federal income tax benefit from a previous deduction taken by the class member. However, Fund is unaware of whether a class member took a deduction in a

previous year and the amount by which the deduction reduced the class member's federal income tax liability. Thus, Fund is unable to determine if a cash distribution to class members is includible in the gross income of a class member and the amount of the gross income inclusion, if any.

### 3. No Reporting Requirements to Class Members for Costs and Fees Paid From Fund

Section 1.468B-2(l)(2)(ii)(C) provides, in part, that for purposes of section 6041(a), if a qualified settlement fund makes a payment or distribution on behalf of a transferor or a claimant, the fund is deemed to make the payment or distribution to the recipient of that payment or distribution in the course of a trade or business.

Section 1.468B-2(l)(2)(ii)(D) provides that with respect to a payment or distribution on behalf of a transferor or a claimant and the information reporting requirements of sections 6031 through 6060, the qualified settlement fund is also deemed to have made the payment or distribution to the transferor or claimant.

Section 1.6041-1(d)(2) provides that fees for professional services paid to attorneys are required to be reported in returns of information if paid by persons engaged in a trade or business and paid in the course of such trade or business.

Section 6045(f) of the Code requires any person engaged in a trade or business and making a payment in the course of such trade or business to file information returns with respect to any payment to an attorney in connection with legal services, unless such payment is reportable under section 6041(a) or section 6051 of the Code.

Based on the facts represented, Fund does not have an information reporting requirement under section 6041(a) to the class members for amounts paid by Fund for the administration costs and attorneys' fees paid to class counsel. The payments are not payments or distributions made on behalf of the class members as described in sections 1.468B-2(l)(2)(ii)(C) and (D). Furthermore, payments made to class counsel in an opt-out class action are not income to the class members. In opt-out class actions, a class member obtains the benefits of an opt-out class action merely by coming within the definition of the class, unless the member affirmatively excludes himself from the lawsuit. The Service has consistently ruled that a class member's non-inclusion of payments to class counsel in an opt-out class action is consistent with Situation 3 of Rev. Rul. 80-364, 1980-2 C.B. 294. (But cf. Sinyard v. Comm'r, T.C. Memo 1998-364, aff'd, 268 F.3d 756 (9<sup>th</sup> Cir. 2001), cert. denied sub nom, Sinyard v. Rossotti, 536 U.S. 904 (2002) (settlement of opt-in class action pursuant to Age Discrimination in Employment Act where class members had contingency fee agreements with counsel); and Fredrickson v. Comm'r, T.C. Memo 1997-125, aff'd in unpub. opinion, 97-71051 (9<sup>th</sup> Cir. 1998) (settlement of mandatory, Title VII class action, where class members personally signed settlement agreements providing for compensation of counsel). In situation 3 of Rev. Rul. 80-364, 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 attorneys' 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 union for attorney's fees was a reimbursement for expenses incurred by the union and not includible in the gross income of the union members.

### CONCLUSIONS

Based solely on the information provided and the representations made, we conclude as follows:

1. Fund is a qualified settlement fund described in section 1.468B-1 of the regulations;
2. Fund does not have a reporting obligation under section 6041 of the Code for distributions made to class members; and
3. Fund does not have a reporting obligation to class members under section 6041 of the Code for amounts paid from Fund for administration costs and attorneys' fees paid to class counsel.

The rulings contained in this letter are based upon information and representations submitted by Fund 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.

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. This ruling is directed only to Fund 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 on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Jeffery G. Mitchell  
Branch Chief, Branch 6  
(Income Tax & Accounting)