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Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:
(202) 622-4910
Refer Reply To:
CC:PA:APJP:1/PLR-159425-01
Date:
February 28, 2002

In re:

LEGEND

Trust =

Settlement Agreement =

Company =

Products =

Date a =

Date b =

Court =

Class Members =

x =

y =

z =

x-related Test =

Option =

Dear

This letter responds to the letter dated October 24, 2001, submitted on behalf of the Trust, requesting the following rulings:

(1) Payments by the Trust of the following amounts from Fund A and Fund B to Class Members, as described below, are not subject to information reporting under § 6041 and withholding under § 1441:

- (a) reimbursement of medical monitoring expenses and/or amounts for mileage;
- (b) refunds of the costs of Products;
- (c) cash in lieu of medical monitoring benefits; and
- (d) Fund B Matrix Compensation Benefits;

(2) Trust need not file duplicate payee statements to Class Members on whose behalf it makes payments for medical monitoring expenses directly to the medical service provider; and

(3) Payments from Fund B of attorneys' fees to class counsel and common benefit attorneys, and payment of amounts to fund medical research and education, are not made "on behalf of" any specific class member within the meaning of § 1.468B-2(1)(2)(ii), and therefore, the Trust need not send a duplicate payee statement to any class member with respect to such payments.

Facts

Based upon the facts and the representations made, Trust is structured and managed to qualify as a "qualified settlement fund" ("QSF") under § 468B of the Internal Revenue Code ("Code").

Trust was formed to administer a Settlement Agreement of class action lawsuits that arose out of the marketing and sale by Company of Products. Various nationwide and statewide class actions alleged that Products caused personal physical injury and physical sickness, including x. Following extensive litigation, Settlement Agreement was approved on Date a, by Court.

Plaintiff Settlement Class and Subclasses

The Class Members consist of individuals who used the Products and (1) have not been diagnosed by a qualified physician as y by an x-related Test, (2) have been diagnosed by a qualified physician as y, and (3) have been diagnosed by a qualified physician as having z by an x-related Test, but who have not been diagnosed as y.

Fund A and Fund B

The Settlement Agreement establishes Fund A and Fund B. In general, Fund A will be used to pay for medical monitoring of the conditions of Class Members, who have not been diagnosed as y. The medical monitoring payments include:

- (1) medical services provided directly to Class Members through a screening program, including an x-related Test and associated interpretive physician visit,
- (2) reimbursements for medical services obtained by Class Members independent of the screening program,
- (3) refund of the cost of Products, and
- (4) cash in lieu of medical services.

Fund A will also be used to finance medical research and education, and to maintain a registry to track the medical conditions of Class Members. None of the members of the settlement class entered into any agreements to pay Trust's administrative costs or to fund medical research or education. Fund A will also be used to pay attorneys' fees for services related to Fund A.

Fund B will pay compensation to Class Members, who have been diagnosed as y or diagnosed as having z. Fund B will be used to pay attorneys fees for services related to Fund B.

The Settlement Agreement states that all of the amounts being paid pursuant to the terms of this settlement are being paid as damages (other than punitive damages) on account of alleged physical personal injuries or alleged physical sickness of the members of the settlement class as described in § 104(a)(2) of the Code. The agreement also states that the claims have their origin in such alleged physical personal injuries or physical sickness.

The ruling request notes that certain Class Members do not have a y diagnosis before Date b, but are at "increased risk of disease" by reason of having used the Products.

Attorneys Fees

Payments will be made from both Fund A and Fund B to class counsel and common benefit attorneys, for their work related to either Fund. None of the members of the settlement class signed any contingency fee agreement or otherwise agreed to pay the fees of class counsel or common benefit attorneys, who do not otherwise represent any individual member of the settlement class. Class counsel are the attorneys executing the Settlement Agreement on behalf of the class representatives, including other attorneys approved by the court as counsel to the settlement class. Common benefit

attorneys are attorneys who contributed to the creation of the Trust through work devoted to the common benefit of class members, including attorneys who conferred such benefits through state court litigation.

Applicable Law

Section 1.468B-2(l)(2)(i) of the Income Tax Regulations (“Regulations”) provides that, in general, payments and distributions by a QSF are subject to the information reporting requirements of part III of subchapter A of chapter 61 of the Code, and the withholding requirements of subchapter A of chapter 3 of subtitle A and subtitle C of the Code.

Section 1.468B-2(l)(2)(ii) provides that a QSF must make a return for, or must withhold tax on, a distribution to a claimant if one or more transferors would have been required to make a return or withhold tax had that transferor made the distribution directly to the claimant. For purposes of §§ 6041(a) and 6041A, if a QSF 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. In such situation, the QSF is also deemed to have made the distribution or payment to the transferor or claimant.

Section 6041(a) provides 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 setting forth the amount of such gains, profits, and income, and the name and address of the recipient.

Section 6041(d) provides that every person required to make a return under subsection (a) shall furnish to each person with respect to whom such a return is required a written statement.

Section 1.6041-1(c) of the regulations states that payments are fixed when they are 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.

Section 871(a) of the Code imposes a 30 percent tax on U.S. source interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income (FDAP) received by nonresident aliens.

Section 1441(a) provides, in general, that all persons, in whatever capacity acting, having the control, receipt, custody, disposal, or payment of items of income that are FDAP shall deduct and withhold the tax from such items.

Section 1.1441-2(b)(1) provides, in relevant part, that FDAP does not include items of income excluded from gross income under a provision of law without regard to the U.S.

or foreign status of the owners of the income.

Section 61(a) provides the general rule that, except as otherwise provided by law, gross income includes all income from whatever source derived.

Section 104(a) states that gross income does not include the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or periodic payments) on account of personal physical injuries or sickness. However, this exclusion does not apply to amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year.¹

Section 1.104-1(c) provides, in part, that the term “damages received (whether by suit or agreement)” means an amount received through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

Discussion

Furnishing of, or Reimbursement for, Medical Services

Section 61(a) provides generally that, except as otherwise provided by law, gross income includes all income from whatever source derived. In United States v. Glenshaw Glass Co., 348 U.S. 426 (1955), 1955-1 C.B. 207, the Supreme Court of the United States held that the concept of gross income encompassed accessions to wealth, clearly realized, over which taxpayers have complete dominion.

With respect to payments or reimbursements of medical services, the expense would not have been incurred but for the alleged action or inaction of the Company. A Class Member receiving this service or reimbursement has no accession to wealth and thereby does not realize gross income. This conclusion is based on the assumption that the Class Member did not receive a tax benefit through a prior deduction for the cost of the medical care.

Therefore, to the extent the Trust does not have actual knowledge that the Class Members received a tax benefit through a deduction for the cost of the Product, the Trust is not subject to the reporting requirements of § 6041 or the withholding requirements of § 1441 in relation to Class Members.

Refund of Cost of the Products

¹ Medical care, as described in § 213(d)(1)(A) and (B), means amounts paid for the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body, and for transportation primarily for and essential to such medical care.

A rebate or reduction in the purchase price of an item is not includible in the buyer's gross income. Rev. Rul. 76-96, 1976-1 C.B. 23; and Rev. Rul. 84-41, 1984-1 C.B. 130.

With respect to refunds for the cost of the Products, the Products purchased by the Class Members were manufactured by the Company. Under the agreement a Class Member receives a refund of the Products' costs, up to a stated maximum dollar amount. The Company is the source of the funds used to make the refunds. Thus, the refund will be treated as a reduction in the purchase price and will not result in gross income to a Class Member. This conclusion is based on the assumption that the Class Member did not receive a tax benefit through a prior deduction for the cost of the Product. It is further based on the assumption that the refund does not exceed the amount paid by the Class Member for the Products.

Therefore, to the extent the Trust does not have actual knowledge that the Class Members received a tax benefit through a deduction for the cost of the Product, the Trust is not subject to the reporting requirements of § 6041 or the withholding requirements of § 1441 with respect to such payments.

Cash in Lieu of Medical Services

In general, §104(a)(2) provides an exclusion from gross income for damages received whether by suit or agreement on account of personal physical injuries or physical sickness. However, this exclusion does not apply to amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year.

With respect to cash in lieu of medical services, a Class Member is entitled to medical services or cash in lieu thereof only if the Class Member has been diagnosed with a diagnosis of x or y or of a more serious condition. Accordingly, under § 104(a)(2) the value of such services or cash in lieu thereof is not includible in the gross income of a Class Member. This conclusion does not apply to an amount received attributable to (and not in excess of) a prior deduction allowed under § 213.

Significantly, however, deductions available to nonresident alien individuals are limited to state and local income taxes, charitable contributions, casualty or theft losses, job expenses, and other miscellaneous deductions. Because nonresident aliens are not allowed deductions under § 213, an amount distributed from Fund A or B to a nonresident alien could be subject to withholding under § 1441 only if: 1) the nonresident alien was a *resident* alien in the year the Product was purchased or medical services received; and 2) the resident alien deducted the corresponding expenses under § 213.

In addition, as used in § 6041, the phrase "gains, profits, and income" means gross income and not the gross amount paid. A payor is not required to make a return under § 6041 for payments that are not includible in the recipient's income, nor is a payor required to make a return if the income is not fixed or determinable. If the payor does

not have a basis to determine the amount of gross income then the payment is not fixed or determinable. See Rev. Rul. 80-22, 1980-1 C.B. 286, amplified by Rev. Rul. 82-93, 1982 - 1 C.B. 196.

The payments for medical services may be includible in the gross income of the Class Members to the extent of any federal income tax benefit of a previous deduction. However, to the extent the Trust does not have actual knowledge of whether a particular Class Member itemized § 213 deductions such payments are not fixed or determinable income. Therefore, if the Trust has no knowledge of the individuals' prior return positions (if any) and, more importantly, the individuals are not required to provide such information to the Trust, then the amount of income, if any, resulting from the payment is not fixed or determinable by the Trust. Under these facts, withholding under § 1441 is not necessary for amounts paid from Funds A and B to a nonresident alien Class Member. In addition, the payments for medical services to the Class Members are not subject to the reporting requirements of § 6041 regardless of whether the Class member previously deducted expenses under § 213.

Matrix Compensation Benefits

As in the case of payments of cash in lieu of medical services, a Class Member is entitled to Matrix Compensation Benefits after a diagnosis of y or z. Thus, the conclusion as to Matrix Compensation Benefits is the same as under cash in lieu of medical services.

As a result, the Trust is not subject to the reporting requirements of § 6041 or the withholding requirements of § 1441 with respect to such payments.

Payments for Research and Education

The payments to finance medical research and education are not made to or on behalf of any specific Class Member and benefit Class Members only in a general sense. Thus, there is no accession to wealth to a Class Member and no gross income results to a Class Member within the meaning of Glenshaw Glass Co.

Therefore, the Trust is not subject to the reporting requirements of § 6041 or the withholding requirements of § 1441 in relation to such payments.

Attorney Fees

A taxpayer must include in gross income that portion of taxable damages paid to his or her attorney as attorneys fees, even if the defendant makes the payment directly to the taxpayer's attorney. See Alexander v. Internal Revenue Service, 72 F.3d 938 (1st Cir. 1995), and Baylin v. United States, 43 F.3d 1451 (Fed. Cir. 1995). However, this rule does not apply to payment of attorneys fees to class counsel resulting from settlement of a class action lawsuit, because the class members have not personally agreed to compensate class counsel. See Rev. Rul. 80-364, 1980-2 C.B. 294 (Situation 3)

(portion of settlement paid by union for attorneys fees was a reimbursement for expenses incurred by the union and not includible in the gross income of the union members).

Accordingly, with respect to attorney fees, the amount paid as attorneys fees to Class Counsel and Common Benefit Attorneys does not constitute gross income to a Class Member.

Therefore, the Trust is not subject to the reporting requirements of § 6041 or the withholding requirements of § 1441 with respect to such payments.

Rulings

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

(1) Payments by the Trust of the following amounts from Fund A and Fund B to Class Members, as described below, are not subject to information reporting under § 6041 and withholding under § 1441:

- (a) reimbursement of medical monitoring expenses and/or amounts for mileage;
- (b) refunds of the costs of Products;
- (c) cash in lieu of medical monitoring benefits; and
- (d) Fund B Matrix Compensation Benefits;

(2) Trust need not file duplicate payee statements to Class Members on whose behalf it makes payments for medical monitoring expenses directly to the medical service provider; and

(3) Payments from Fund B of attorneys' fees to class counsel and common benefit attorneys, and payment of amounts to fund medical research and education, are not made "on behalf of" any specific class member within the meaning of § 1.468B-2(1)(2)(ii), and therefore, the Trust need not send a duplicate payee statement to any class member with respect to such payments.

This ruling is based on the facts presented and the applicable law in effect on the date of this letter. If there is a change in material fact or law (local or federal) before the transactions considered in this ruling take effect, the ruling will have no force or effect.

Except as specifically ruled herein, no opinion is expressed as to the federal tax treatment of any issue addressed in this ruling under other provisions of the Internal Revenue Code and Regulations that may be applicable.

Pursuant to the power of attorney on file in this office, the original of this letter is being sent to you as the Trust's representative.

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

Sincerely,
John J. McGreevy
Assistant to the Branch Chief, Branch 1
Office of the Assistant Chief Counsel
(Administrative Provisions and
Judicial Practice)

Enclosure (2)

Copy of this letter
Copy for section 6110 purposes

cc: