

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

Number: **200625031**

Release Date: 6/23/2006

Index Number: 61.00.00-00, 6041.00-00,  
6041.03-00

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:ITA:B04  
PLR-155282-05

Date:  
March 14, 2006

Taxpayer =

State A =

State B =

State C =

Date 1 =

Date 2 =

Dear :

This letter responds to your request for a private letter ruling regarding the information reporting requirements for attorneys' fees paid in connection with the settlement of an "opt-out" class action lawsuit under § 6041 of the Internal Revenue Code. Specifically, you requested a ruling that the attorneys' fees paid pursuant to the "Settlement Agreement" to "Class Counsel" are not subject to information reporting to such "Class Members" and "Class Representatives" under § 6041.

**FACTS**

Taxpayer, a State A corporation, is the parent of an affiliated group filing a consolidated Federal income tax return. Taxpayer is in the business of providing telecommunications services.

On Date 1, a class action complaint was filed against Taxpayer (the National Class Action). The state court certified the class (Class) and appointed class counsel (Class

Counsel). The National Class Action was later removed to Federal Court. The complaint sought compensatory and punitive damages, as well as injunctive relief. A number of separate statewide class actions, containing similar claims and seeking similar relief were later transferred to Federal Court for consolidated and coordinated pretrial proceedings with the National Class Action. Taxpayer has settled and is continuing to attempt to settle these suits on a state-by-state basis.

This ruling request involves an “opt-out” settlement agreement regarding a class action suit filed in State C (the Settlement Agreement). An opt-out settlement agreement is an agreement executed in connection with a class action suit in which potential class members have the right to exclude themselves from the settlement class if they so desire. All potential members who do not opt-out are part of the settlement class.

In the present case, the deadline to “opt-out” was Date 2. Those who remained in the settlement class are entitled to receive cash benefits. A claims office is responsible for receiving, processing, classifying and paying qualified claims. Claims are paid out of an account funded by Taxpayer and referred to as the “Claimant Account.” In addition, Taxpayer is required to pay all reasonable costs of administering the Settlement Agreement by making payments to an “Administrative Account.” The Claimant Account and the Administrative Account together constitute a Qualified Settlement Fund within the meaning of § 468B.

Under the terms of the Settlement Agreement, the Taxpayer is also required to pay attorneys’ fees to class counsel in an amount approved by the court but not to exceed 20 percent of the total potential claimant benefits. Taxpayer intends to issue a Form 1099 to class counsel reporting the attorneys fees paid to class counsel.

The claims office will also issue Forms 1099 to class members who receive payments for their qualified claims in excess of \$600 in accordance with §§ 1.468B-2(l)(2), 1.6041-1(a) and 1.6045-4(a) of the Income Tax Regulations. This letter ruling request concerns whether the Taxpayer, under § 6041, must report on the Forms 1099 sent to Class Members a pro-rata share of the attorneys’ fees paid to Class Counsel under the Settlement Agreement.

## LAW & ANALYSIS

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 § 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, in the present case, § 6041 requires the Taxpayer to report only those payments in excess of \$600 includible in the Class Members' gross income under § 61.

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).

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, the taxpayer receives the benefit of the payment, and the amount is therefore gross income. 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.

The rationale of *Old Colony Trust* is not applicable, however, in certain opt-out class action lawsuits where, although the class members may receive a benefit from the litigation, no express contractual liability for a fee exists between the class members and litigating counsel. In such cases where there is no contractual agreement and someone other than the class members is liable for payment of attorneys' fees incurred in connection with such litigation, the attorneys' fees are not includible in a class member's gross income.

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. *But Cf. Sinyard v. Commissioner*, 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. Commissioner*, 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 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 paid by Taxpayer to Class Counsel in an amount approved by the court under the Settlement Agreement. 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 by Taxpayer is similar to Situation 3 in Rev. Rul. 80-364 and not income to the Class Members or the Class Representatives.

As discussed above, the term "income" under § 6041 is interpreted to mean income includible in gross income under § 61. Therefore, because, in the present case, the amounts paid by Taxpayer to Class Counsel for attorneys' fees are not income to the Class Members or the Class Representatives, the payments of attorney fees are not subject to information reporting to any Class Member, including any Class Representative, under § 6041.

## CONCLUSIONS

Based on the facts and information submitted and the representations made, we rule as follows:

The amounts paid by Taxpayer to Class Counsel for attorneys' fees are, under § 6041, not subject to information reporting to the Class Members or the Class Representatives on Form 1099.

This letter ruling is based on facts and representations provided by the Taxpayer and its authorized representatives, and is limited to the matters specifically addressed in the letter. 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 Taxpayer'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) provides that it may not be used or cited as precedent. In addition, we have enclosed a copy of the letter showing the deletions proposed to be made when it is disclosed under § 6110.

Sincerely,

Michael J. Montemurro  
Branch Chief, Branch 4  
(Income Tax & Accounting)