



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR: NANCY W. HALE,
ASSOCIATE AREA COUNSEL
(SB/SE Area 3)

FROM: James L. Atkinson
Acting Associate Chief Counsel
(Income Tax and Accounting)

SUBJECT: Settlement Payments for Avigation Rights

LEGEND:

Airport =
Airport Authority =
X =
\$Y =

FACTS:

This is in response to your request for help in answering questions about the treatment, for federal income tax purposes, of cash payments made in settlement of the conversion of avigation rights of affected property near Airport. Airport Authority agreed to pay a class of X affected landholders the total sum of \$Y. Part of the settlement is for legal fees and for special awards to named plaintiffs. You request our help in presenting a public response to some of the more common questions being asked.

STATEMENTS OF GENERAL PRINCIPLES:

The following are statements of general principles which we feel are responsive to most questions raised and applicable to the majority of situations in which the affected taxpayers may find themselves:

- Legal fees paid directly to class counsel are not income, profits, or gain to a taxpayer if the taxpayer does not have a separate contingency fee arrangement with the class counsel and the class action is an opt-out

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class action. Sinyard v. Commissioner, T.C.M. 1998-364, aff'd, 268 F.3d 756 (9th Cir. 2001), Frederickson V. Commissioner, T.C.M. 1997-125, aff'd in unpub. opinion, 166 F.3d 342 (9th Cir. 1998), and Rev. Rul. 80-364 (situation 3), 1980-2 C.B. 294.

- Special awards paid to claimants who actively aided in prosecution of the class action or who devoted substantial time or expense on behalf of the settlement class are payments for services rendered and are includible in gross income under § 61(a)(1).
- Payments received by current owners of businesses and principal residences are first applied to reduce their basis in the property. Inaja Land Company v. Commissioner, 9 T.C. 727 (1947), acq. 1948-1 C.B. 2, and Rev. Rul. 54-575, 1954-2 C.B. 145, modified by Rev. Rul. 72-433, 1972-2 C.B. 470. We are not addressing the situation of an award that exceeds a current owner's basis in property because the number of claimants in that situation should be negligible.
- The avigation easements should be considered property that was involuntarily converted by the authority pursuant to a seizure under § 1033(a) or § 1033(g). See Rev. Rul. 79-269, 1979-2 C.B. 297 (stating that a seizure occurs when a government authority enters into physical possession of property or acquires it for public use, without authority of a court order with compensation to be determined later). Thus, taxpayers may elect to apply § 1033 with respect to payments received for the avigation easements if all the other requirements of § 1033 are met. Because we cannot anticipate all the various factual situations of former and current owners, we cannot address any other aspect of the application of § 1033 to the payments.

APPLICATION:

You may present this response to the public in the form of a news release or in some other format for general dissemination. We realize that these statements do not address all of the situations in which affected taxpayers find themselves. However, as unique questions arise, we will address them separately as appropriate on a case by case basis.

Any questions or concerns you may have regarding the contents of this memo or other situations as they arise may be directed to Mr. J. Peter Baumgarten of my office at

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