

Internal Revenue Service

Department of the Treasury

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UIL: 6050E.00-00

[REDACTED]

Washington, DC 20224

Person to Contact: [REDACTED]

[REDACTED]

Telephone Number: [REDACTED]

Refer Reply to: GENIN-103116-04

CC:PA:ITA:B4

Date:

3/5/04

Dear Mr [REDACTED]:

This letter is in response to your request for informal advice on whether attorneys' fees and administrative costs recovered in a class action lawsuit are includable in the gross incomes of the individual class members. In your request you state that, after an [REDACTED] state tax provision was ruled unconstitutional, the state settled a class action by creating a common fund for the class members. The fund comprised the total overpaid state taxes, plus interest thereon. Pursuant to the settlement agreement, fees incurred by class counsel are to be paid from this fund and class members receive a pro rata share of the tax overpayment after payment of counsel fees and expenses of administration. No individual class member contracted with counsel for the provision of legal services. You have also indicated that the members of the class exceed 800,000.

Section 6050E of the Internal Revenue Code requires all persons making payments of refunds of State or local income taxes aggregating \$10 or more to file an information return reporting such payment. Refunds of State or local income taxes are reported on Form 1099-G, Certain Government Payments. A state tax refund must be reported on Form 1099-G unless the payor knows the refund amount is not includible in the payee's income.

Section 61(a) defines gross income as all income from whatever source derived. The Supreme Court has broadly construed this definition in recognition of Congress' intent to tax all gains except those specifically exempted. The Court has long held that gain is taxable when a taxpayer receives the benefit of the gain. A taxpayer can receive the benefit of the gain not only by being paid, but also by otherwise obtaining the fruition of the economic gain which has already accrued to him. For example, a taxpayer realizes income when a third party satisfies a financial obligation of the taxpayer; the taxpayer is treated as having received that amount and is taxed accordingly. This is true regardless of whether the amount ever passed through the taxpayer's hands.

Generally, if proceeds from a lawsuit are includible in the prevailing party's income, attorneys' fees paid from such proceeds are likewise includable in the gross income of the prevailing party. *Sinyard v. Commissioner*, 268 F.3d 756 (9th Cir. 2001), cert. denied sub nom, *Sinyard v. Rossotti*, 122 S.Ct. 2357 (2002) (taxpayer must include in

gross income attorneys' fees paid to class counsel in opt-in class action). See *also* Rev. Rul. 80-364, 1980-2 C.B. 294, Situation 1. Under certain circumstances, however, the Service has declined to apply this general rule. For example, Situation 3 of Rev. Rul. 80-364 concludes that attorneys' fees recovered by a union for vindicating the rights of the bargaining unit are not includable in the gross income of the union members because the payment of attorney fees by the union was a payment of an expense of the union.

Under the facts of this case, we do not believe the portion of the fund used to pay attorneys' fees and administrative costs is includible in the gross income of the class members. Thus, only the amount actually paid to class members is reportable on Form 1099-G to the class members. The instructions to Form 1099-G state that if a tax refund includes \$600 or more in interest, the interest payment should be reported on Form 1099-INT. If the interest component is less than \$600, however, it should be reported in the blank box on Copy B of the 1099-G, accompanied by an explanatory notation such as "interest income."

If you have any questions, please call [REDACTED], at [REDACTED].

Sincerely,

Robert A. Berkovsky
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)