



for amounts paid in settlement of a class action lawsuit. Specifically, you have requested the following three rulings:

- (1) The Settlement Fund does not have a reporting obligation under section 6041 of the Internal Revenue Code (I.R.C.) for payments made to the class members.
- (2) The Settlement Fund does not have a reporting obligation under section 6049 for payments made to the class members.
- (3) The Settlement Fund has a reporting obligation under section 6045(f) for amounts paid as attorney fees to attorneys for the class members.

### FACTS

The rulings contained in this letter are based on the information and factual representations set out in the request and accompanied by a penalty-of-perjury statement executed by an appropriate party. While this office has not verified the information submitted in support of the request, it is subject to verification on examination. The pertinent facts are summarized below.

The Settlement Fund is characterized in your request as a qualified settlement fund as defined in section 468B. No opinion is expressed herein as to whether the Settlement Fund is indeed a section 468B QSF. The rulings below are based on the premise that the Settlement Fund is a QSF.

The Settlement Fund is organized under the jurisdiction of the Court and was formed to administer a settlement agreement reached between the parties to a lawsuit alleging antitrust violations that occurred during the period of Date 1 to Date 2. This lawsuit began in Year 1, when various retailers and retail trade associations (the class members) filed a class action lawsuit against Defendant 1 and Defendant 2. The class action was an “opt-out” class action, meaning that class members could opt to be excluded from the class and not be bound by an eventual judgment.

In Year 2, the Defendants agreed to a settlement of the class members’ claims. In Year 3, the terms of the settlement agreement were finalized and the Court granted final approval. Pursuant to the settlement agreement, the defendants agreed to pay Amount 1 as compensation to the class members. The money will first be used to pay administrative costs, attorney fees of the class members’ attorneys, and taxes on any interest income generated on the settlement funds. The balance available after these payments will be distributed to the class members. All taxes on the interest earnings of the Settlement Fund are the responsibility of the Settlement Fund. The Claims Administrator is the appointed administrator of the fund.

The Settlement Fund will make distributions to the class members in accordance with the procedures set forth in a court-approved allocation plan. In general, the amounts to be paid to class members under the plan are calculated using estimates of the amount each class member was damaged, which is based, if available, on the total amount of the class member's retail sales transactions with the defendants during the applicable period. If the specific data on a class member's volume of sales is available, the class member is given a claim form and notice of the estimated settlement payment. The class member has the right to challenge the estimated amount. If transactional data for a class member is unavailable, the class member is given a different claim form, which requests data on the class member's total U.S.-based sales during the period and a percentage breakdown of those sales by merchant category. Neither claim form requests information about the class members' tax treatment of any amounts paid to the defendants as part of the sales transactions. Likewise, according to your request, the Settlement Fund does not know whether or to what extent any class members deducted from taxable income amounts paid to the defendants. Nor does the Settlement Fund know anything else about the class members' federal income tax matters, including whether the payments made to the class members out of the fund will be taxable income to the members.

## LAW AND ANALYSIS

### A. Overview

Sections 6041, 6045, and 6049 require the filing of information returns with the Internal Revenue Service under specified circumstances. The first of these, section 6041, requires anyone "engaged in a trade or business and making payments 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 (other than payments . . . [reportable under certain other sections, including] section . . . 6049(a) . . . or 6045), of \$600 or more in any taxable year" to report on an information return the amount of the gains, profits, or income paid and the name and address of the recipient. I.R.C. § 6041(a). The \$600 limit is measured as an aggregate of payments to the payee during the taxable year. Treas. Reg. § 1.6041-1(a)(1)(i). The IRS has designated Form Series 1099 to report section 6041(a) payments.

Section 6045 concerns information returns by "brokers." Under section 6045(a), every person doing business as a broker must, when required by the Secretary, file a return showing the name and address of each customer, along with the details regarding gross proceeds and other information as prescribed by form or regulation. A "broker" includes a dealer, a barter exchange, and any other person who for a fee regularly acts as a middleman of property or services. I.R.C. § 6045(c). With certain exceptions, a broker must file an information return for each sale the broker makes on behalf of a customer in the ordinary course of the broker's trade or business as a

broker. Treas. Reg. § 1.6045-1(c)(2). Section 6045(f) contains a provision on payments to attorneys for legal services. The payor must report the payment if made in the course of a trade or business, unless the payment is reportable under section 6041(a) or would be reportable except that it is below that section's dollar threshold. Form 1099-B, *Proceeds From Broker and Barter Exchange Transactions* (or other applicable Form 1099) is used for information reporting under section 6045.

Section 6049 applies to interest payments. If the interest paid to another person aggregates \$10 or more during any calendar year, then the payor must report to the IRS the aggregate amount and the name and address of the payee. I.R.C. § 6049(a). Reportable interest is defined in section 6049(b) and section 1.6049-5(a) of the Income Tax Regulations as interest that is earned on: (1) instruments of corporate debt that are either issued in registered form or offered to the public, other than an obligation with a maturity date of up to one year from the date of issue; (2) deposits, investment certificates, and shares maintained with banks and similar financial institutions that can be withdrawn or repurchased; (3) amounts held by insurance companies; (4) deposits with brokers (as defined in section 6045(c)); and (5) amounts held by investment companies or invested in pooled funds or trusts. Section 6045(c) brokers are subject to the interest reporting requirement when they act as "middlemen." Treas. Reg. § 1.6049-4(b)(3), (f)(4)(i). Interest payments not reportable under section 6049 are potentially reportable under section 6041. Form 1099-INT is the designated form for reporting interest under section 6049.

QSFs are subject to the information reporting requirements of these sections. Treas. Reg. § 1.468B-2(l)(2)(i) (stating in general that payments and distributions by a QSF are subject to the information reporting requirements). A QSF must make a return for, or must withhold tax on, a distribution to a fund claimant if one or more of the transferors who funded the QSF would have been required to make a return or withhold tax if the transferor(s) had made the distribution directly to the claimant. Treas. Reg. § 1.468B-2(l)(2)(ii)(A). If a QSF makes a payment or distribution on behalf of a transferor or a claimant, the fund, and not the transferor or the claimant, is deemed to have made the payment or distribution to the recipient for purposes of the information reporting provisions. Treas. Reg. § 1.468B-2(l)(2)(ii)(D). The QSF is also deemed to have made the payment in the course of the QSF's trade or business for purposes of section 6041(a). Treas. Reg. § 1.468B-2(l)(2)(ii)(C). Once made, whether a distribution or payment to a claimant is includible in the claimant's gross income ordinarily depends on the nature of the underlying claim and is determined as if the transferor made the payment or distribution directly to the claimant. Treas. Reg. § 1.468B-4.

#### B. Settlement Payments to Class Members Are Not Reportable Under Section 6041(a)

As mentioned, section 6041(a) basically requires the reporting of payments of at least \$600 made in the conduct of a trade or business. To trigger the requirement, a

payment must be of “fixed or determinable” income. Income is an open-ended concept and can effectively be anything used as payment. I.R.C. § 61(a) (defining gross income as all income from whatever source); Treas. Reg. § 1.61-1(a) (providing that income may be realized in any form); *United States v. Fairchild Indus. Inc.*, 464 F. Supp. 1285, 1292 (D. Md. 1979) (holding that income in the tax context “is a broad term” that includes “all payments” unless specifically excluded by statutory or decisional law). The Supreme Court has characterized income as “accessions to wealth, clearly realized,” over which a taxpayer has complete control. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 477 (1955).

While any accession to wealth can be income, not all income is fixed or determinable. Income is “fixed” when it is to be paid in amounts definitely predetermined. Treas. Reg. § 1.6041-1(c). Income is “determinable” when there is a basis of calculation by which the amount to be paid may be ascertained. *Id.* Because section 6041(a) is conditioned on a payor knowing that a payment to a payee is in the nature of income and the amount of income, if a payor cannot determine either that a payment is in the nature of income or in what amount, then the payor is not required to file an information return under the section. For instance, the Service ruled in Rev. Rul. 80-22, 1980-1 C.B. 286, that an insurance company was not required to file returns under section 6041(a) for crop insurance proceeds paid to certain farmers because the insurer did not know if the payments were income. For farmers who had informed the insurance company that they were required to capitalize farming expenses, the amount of insurance proceeds constituting income depended on each farmer’s basis in the destroyed crops. That information was not known to the insurance company, and the company could not require the farmers to disclose the information.

The Settlement Fund certainly knows the amount of all payments to class members, but for section 6041(a) to apply, the fund must also know if the payments are income. The payments to class members (excluding interest on the payments, addressed in the next section) are characterized in your request as “calculated to account for overcharges and damages incurred by each [class member]” and are “compensation for [their] destroyed or injured capital.” In other words, the members paid the overcharges out of capital as a cost of doing business, and the payments back to the members out of the settlement funds are a return of capital. Subject to the tax benefit limitation described below, if damages awarded in litigation or paid in settlement of litigation are a return of capital, as opposed to a recovery of lost profits, then the damages are excluded from the claimant’s taxable income to the extent of the claimant’s basis in the lost or damaged capital item or asset.<sup>1</sup> *Raytheon Prod. Corp. v. Commissioner*, 144 F.2d 110, 133-14 (1st Cir. 1944); *State Fish Corp. v. Commissioner*, 48 T.C. 465, 472-73 (1967), *modified on other grounds*, 49 T.C. 13 (1967), *acq.*, 1968-2

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<sup>1</sup> Your ruling request asserts the additional argument that the payments to class members are not includible in the members’ gross income because the payments are rebates or refunds of prior payments, akin to rebates or refunds of a buyer’s purchase price or a taxpayer’s state or local taxes. We find it unnecessary to discuss this issue and express no opinion on it.

C.B. 1. Insofar as the class members' lost capital was in the form of excessive fees charged by the defendants as part of the members' retail sales, then each member's basis in the lost capital should presumably be the amount of the overcharges, so that the corresponding compensation should be equal to, and not exceed, the basis. The litigation does not present the situation where the lost capital is an asset that has appreciated in value since it was acquired, such as real property, with the result that compensation for the loss of the asset is likely to yield a gain over basis.

While a return of lost capital is usually not taxable, the exclusion from gross income presupposes that the taxpayer has not already derived a tax benefit from the loss, such as a prior deduction. Section 111(a) articulates the precise rule by providing that a taxpayer's gross income does not include income attributable to a recovery during the taxable year of an amount deducted in a prior taxable year to the extent the amount did *not* reduce the income tax imposed in the prior year. Conversely, gross income must include so much of a recovery payment that matches the amount already deducted, to the extent the deduction *did* reduce the prior year's tax. See *Hillsboro Nat'l Bank v. Commissioner*, 460 U.S. 370 (1983) (discussing the tax benefit rule). The effect of the tax benefit rule can be seen in a number of contexts, for example, casualty losses, real estate tax refunds, and charitable contributions. See Rev. Rul. 74-206, 1974-1 C.B. 198; Rev. Rul. 70-86, 1970-1 C.B. 23; Rev. Rul. 54-566, 1954-2 C.B. 96.

If by its nature a payment to a taxpayer would not be an item of gross income unless the tax benefit rule applies, and the payor has no way of knowing one way or the other, then the payment is not "fixed or determinable" income falling within section 6041(a). That is the case here. Based on the factual statements and representations of the ruling request, a payment to a class member (being a return of transaction fees collected by the defendants) is gross income to the class member only to the extent that the member derived a tax benefit from a previous deduction for the fees. The Settlement Fund affirms that it does not know which or whether any of the class members derived a tax benefit or the amount of any actual tax benefits. Further, the fund cannot require the class members to disclose that information. In the absence of information concerning tax benefits, the Settlement Fund is unable to determine what, if any, part of the payments are gains, profits, or income to the class members; hence, the payments are not payments of fixed or determinable income. Ultimately then, the Settlement Fund has no reporting obligation under section 6041(a) for the distributions to the class members.

#### C. Payments to Class Members Are Not Reportable Under Section 6049(a)

Section 6049(a) requires every person who makes payments of interest (as specifically defined) aggregating \$10 or more to any person during a calendar year to file an information return. If the Settlement Fund payments to the class members include interest within the meaning of section 6049—i.e., from corporate debt, bank accounts, investments, etc.—the Settlement Fund would be required to file an

information return as to any member to whom interest of \$10 or more was paid in a calendar year.

As explained in your request, interest has accrued over time on the corpus of the Settlement Fund and is included in the total pot of money available for distribution to the class members after the satisfaction of taxes and expenses. This interest is not one of the types of interest that when paid to the class members will need to be reported on an information return pursuant to section 6049(a). The fund is not an investment fund; rather, it is a litigation settlement fund, which, as the source of interest paid to class members, is not among those listed in the statute. The class members' entitlement to Settlement Fund payments, including any interest, derives from their status as claimants and is based on their claims for compensation. The interest the class members receive is not paid to them as earnings on their financial holdings (including any holdings of the sort listed in section 6049 and its regulations).

In addition, the amounts paid into the Settlement Fund and the interest earned thereon are stated to be commingled and the Settlement Fund does not have sufficient information to determine the makeup, as between principal and interest, of the payments made to the class members. Assuming that is true, any interest income paid to class members is not fixed or determinable. Consequently, the Settlement Fund does not have a reporting obligation under section 6041(a) with respect to interest payments of \$600 or greater to class members.

D. Fee Payments to Class Members' Counsel Are Reportable Under Section 6041(a) and not Section 6045(f)

Section 6045(f) requires that when any person engaged in a trade or business makes a payment in the course of that trade or business to an attorney for legal services, the payor must file an information return with the Service and furnish an information statement to the attorney. To be reportable, payments to an attorney during a calendar year must total or exceed \$600. Treas. Reg. § 1.6045-5(a)(1). Section 6045(f) applies to a payment to an attorney in connection with the performance of legal services of any sort (whether or not the services are performed for the payor). Section 6045(f)(2)(B), however, exempts from the section's coverage the portion of any payment meeting the criteria for reporting under section 6041(a) (without regard to amount) or section 6051 (not applicable here). Payments to attorneys can be reportable under section 6041(a). Treas. Reg. § 1.6041-(1)(D)(2) (providing that fees for professional services paid to an attorney in the course of a trade or business are required to be reported on an information return).

In the qualified settlement context, payments by a QSF to attorneys representing fund claimants are subject to information reporting. 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 in the course of its trade or business. Treas. Reg. § 1.468B-

2(l)(2)(ii)(C). A “transferor” transfers money or property to the QSF to resolve or satisfy one or more claims against the transferor. Treas. Reg. § 1.468B-1(d)(1).

The Settlement Fund in this case must report, under section 6041(a), payments of \$600 or more (in one year) to attorneys for the class. We find that the requirements for section 6041(a) reporting are met: the payments are made in the course of the Settlement Fund’s trade or business and are of fixed or determinable income. According to the request, the fund payments to attorneys are “on behalf of [the] Defendants.” If so, in making the payments, the Settlement Fund is conducting its trade or business. And by all appearances, the payments are income to the attorneys—the amounts are either predetermined (fixed) or determinable by the Settlement Fund. Because the Settlement Fund is required to report the fee payments under section 6041(a), the Settlement Fund is not required to report the payments under section 6045(f). Treas. Reg. § 1.6045-5(f), Ex. 9 (in the hypothetical situation of a defendant corporation’s transfer to a QSF of \$300,000, out of which the QSF pays \$105,000 to an attorney for the claimant class, the QSF must file an information return under section 6041(a) reporting the \$105,000 payment). Specifically, the payments should be reported on Form 1099-MISC, box 7 (see the *2006 Instructions for Form 1099-MISC* for further information).

## CONCLUSIONS

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

1. The Settlement Fund does not have a reporting obligation under section 6041 for payments made to class members.
2. The Settlement Fund does not have a reporting obligation under section 6049 for payments made to class members.
3. The Settlement Fund has a reporting obligation under section 6041 and not under section 6045 for payments of legal fees to the attorneys for the class members.

Except as expressly provided herein, no opinion is conveyed 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 the taxpayers on whose behalf it was requested. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent. Enclosed is a copy of this letter with redactions required by section 6110.

A copy of this letter must be filed as an attachment to any information return that is filed with the IRS and to which it is relevant. Alternatively, for returns filed



electronically, this requirement may be satisfied by attaching a statement to the return that provides the date and control number of the letter ruling.

Sincerely,

Deborah A. Butler  
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By: \_\_\_\_\_  
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Enclosures

Copy of Letter  
Copy for section 6110 purposes