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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B05
PLR-119923-08
Date:
October 24, 2008

ER =

Class Representatives =

Class Counsel =

State =

Court =

Date 1 =

Date 2 =

Date 3 =

\$a =

Dear :

This responds to your letter dated April 24, 2008, requesting a private letter ruling about the proper federal tax treatment of attorneys' fees paid in connection with the settlement of an opt-out class action lawsuit. In particular, you requested rulings that:

- (1) Attorneys' fees paid to Class Counsel pursuant to the settlement are not includible in the gross income of Class Representatives or Class Members under section 61 of the Internal Revenue Code;
- (2) Attorneys' fees are not subject to information reporting to the Class Members or to Class Representatives under section 6041; and
- (3) Attorneys' fees are not subject to federal employment taxes.

FACTS

ER is organized under the laws of State. Class Members are employees of ER. On Date 1, Class Representatives entered into a retainer and/or contingency fee arrangement with Class Counsel for the purpose of filing a complaint against ER. The contingency fee arrangement provided that if the case was certified as a class action, the attorneys' fees would be set by the court and the payments set forth in the retainer agreement would not apply. The separate fee considerations in the agreement would apply only in the event that the lawsuit was not certified as a class action lawsuit.

On Date 2, a class action lawsuit was filed against ER in Court by Class Counsel on behalf of Class Representatives. The complaint sought recovery for unpaid vacation pay, vacation leave, and attorneys' fees. By order of Court, on Date 3 the lawsuit was certified as an opt-out class action lawsuit, meaning that all persons damaged by ER's conduct were automatically members of the class unless they affirmatively opted-out. Only three individuals elected to opt-out. Class Representatives were the only Class Members to enter into an agreement of any kind with Class Counsel.

The parties agreed to terms of settlement that were approved by order of the Court. Class Members were successful in their claim for vacation leave and vacation pay, and the Court awarded attorneys' fees of \$a to Class Counsel. The amount otherwise payable to Class Members was reduced by the attorneys' fee award paid to Class Counsel prior to distribution to the Class Members.

LAW AND ANALYSIS

Gross Income Defined

Section 61 generally provides that gross income includes all income from whatever source derived. 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 generally is includible in the taxpayer's gross income. *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929). Under the

rationale of *Old Colony Trust*, a prevailing litigant generally must recognize gross income when another party pays attorneys' fees for which the litigant is liable.

Litigants or lawyers who recover funds for the common benefit of persons other than themselves or their clients are entitled to a reasonable attorney's fee from the fund as a whole. *Central Railroad & Banking Co. v. Pettus*, 113 U.S. 116 (1885); *Trustees v. Greenough*, 105 U.S. 527 (1882). The equitable doctrine of "common fund" is a longstanding exception to the general principle that every litigant is responsible for his or her own attorney's fees. *Boeing Co. v. Van Gemert*, 44 U.S. 472 (1980). The common fund doctrine allows spreading the fees among those who benefited from the litigation. *Id.* at 477.

Typically, in class action lawsuits, it is a single class representative who hires the class attorney. Although the other class members may receive a benefit from the litigation, no express contractual liability for a fee exists between them and litigating counsel. Where a taxpayer receives a benefit of litigation but is not liable for payment of attorneys' fees incurred in connection with such litigation, the rationale of *Old Colony Trust Co.* is not applicable. In such opt-out class action lawsuits, the attorneys' fees generally are not includible in a class member's gross income.

Thus, the payment of attorneys' fees to Class Counsel in the instant case is similar to Situation 3 in Rev. Rul. 80-364, 1980-2 C.B. 294. Rev. Rul. 80-364, Situation 3 involved the settlement of a lawsuit brought by a union against an employer to enforce a collective bargaining agreement. In the court-approved settlement, the employer paid the union 40x dollars in full settlement of all claims. After paying out 6x dollars in attorneys' fees, the union distributed 34x dollars to the employees for back pay. The ruling concluded that the portion of the settlement paid by the union for attorneys' fees was a reimbursement for expenses incurred by the union and was not remuneration to the individual employees. The ruling held that the attorneys' fees were not includible in the gross income of the union members and were not wages for purposes of federal employment taxes.

The attorneys' fees in this opt-out class action lawsuit were not awarded to Class Counsel pursuant to any specific fee or retainer arrangement between counsel and the Class Members, including the Class Representatives. Class Members were not under any obligation to compensate Class Counsel. Rather, the attorneys' fees were awarded by Court from the class-wide settlement fund under the common fund doctrine. We conclude that under section 61, the attorneys' fees paid to Class Counsel pursuant to the settlement agreement are not income to the Class Members or to the Class Representatives.

Information Reporting Requirements

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 section 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, section 6041 requires ER to report only those payments in excess of \$600 includible in the Class Members' or Class Representatives' gross income.

In this case, the amounts paid from the common fund to Class Counsel for attorneys' fees are not income to the Class Members or the Class Representatives, as discussed in the first ruling request above. Because “income” under section 6041 is interpreted to mean only income includible in gross income under section 61, the payment of attorneys' fees is not subject to information reporting to any Class Member or to Class Representatives under section 6041.

Federal Employment Taxes

Federal employment taxes in this case consist of taxes under the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and Federal Income Tax withholding. Section 3121(a) relating to the FICA and section 3306(b) relating to the FUTA provide that the term “wages” means all remuneration for employment, with certain exceptions not relevant here. Section 3401(a) relating to Federal income tax withholding, provides that the term “wages” means all remuneration for services performed by an employee for his or her employer, with certain exceptions not relevant here. Under the facts in this case, the attorney fees are not remuneration to the Class Members or to the Class Representatives and therefore are not wages for purposes of federal employment taxes.

CONCLUSIONS

Based on the facts and information submitted and the representations made, the following rulings are issued:

- (1) The attorneys' fees paid to Class Counsel from a common fund pursuant to the settlement are not includible in the gross income of Class Representatives or Class Members under section 61;
- (2) The attorneys' fees are not subject to information reporting to the Class Members or to Class Representatives under section 6041; and
- (3) The attorneys' fees are not subject to federal employment taxes.

This letter ruling is based on facts and representations provided by the Class Representative requesting the ruling. No opinion is expressed about the tax treatment of the transactions considered in this letter ruling under the provisions of any other sections of the Code or regulations which may be applicable. No rulings were requested and none are issued with respect to the federal income and employment tax treatment of the awards granted to the Class Members or to the Class Representatives under the settlement.

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

Because it could help resolve federal tax issues, a copy of this letter should be maintained with the permanent records of the Class Representative requesting the ruling.

Pursuant to a power of attorney on file with this office, copies of this letter ruling are being sent to your authorized representative.

Sincerely,

/s/

Amy J. Pfalzgraf
Senior Counsel, Branch 5
Associate Chief Counsel
(Income Tax & Accounting)

Enclosures:

Copy of this letter

Copy for section 6110 purposes