

**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
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Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:ITA:4  
PLR-133742-12

Date:  
December 11, 2012

In re:

LEGEND:

Act =

Agency =

Agreement =

Court =

Department =

Entity1 =

Entity2 =

Entity2 Claimants =

Incident =

Victim =

Taxpayer =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

x =

y =

f =

\$t = \$

\$u = \$

\$v = \$

\$w = \$

Dear \_\_\_\_\_ :

This is in reply to your request for a ruling on behalf of Taxpayer that any distribution of damages (other than interest) that Taxpayer makes to a Victim is excludable from the

Victim's gross income under § 104(a)(2) of the Internal Revenue Code and, therefore, Taxpayer is not required to report such distribution under § 6041 or withhold a portion of such distribution under § 1441.

## **FACTS**

Each Victim either (i) suffered a cut, scrape, bruise, or other visible physical injury in the Incident, or inhaled thick smoke and, as a result, suffered smoke inhalation during the Incident, or both, (ii) was a close relative (spouse, parent, child, or sibling) of a person who was killed in the Incident, or (iii) was the estate of a person who was killed in the Incident.

During Years 1 through 3, the Victims entered into a retention agreement with Taxpayer and a joint prosecution agreement (JPA) to pursue claims for damages against Entity1 and its officials who were responsible for Incident, as well as against the individual perpetrators of the Incident. The JPA sets forth how the plaintiffs will divide any amounts they recover in litigation or settlement of their claims.

Beginning in Year 4, certain plaintiffs began to dispute the interpretation of the JPA. Those disputes were the subject of arbitration and were ultimately settled ("Settlement"). All of the Victims have agreed to the Settlement, which revises the formula so that the plaintiffs would ultimately divide any amounts recovered under the JPA.

The Victims initially sued Entity1 in Court in Year 3 (the "Lawsuit"). Subsequently, on Date 1, Entity2 passed the Act to provide fair compensation to all Entity2 Claimants who have f claims, including claims for wrongful death and physical injury against Entity1, through a comprehensive settlement of those f claims. Upon Entity1's payment to Entity2, the Act voided all prior court proceedings for f claims by Entity2 Claimants against Entity1 or its officials, and permanently settled the f claims of Entity2 Claimants against Entity1 or its officials. On Date 2, Entity1 and Entity2 entered into the Agreement to resolve all f claims against Entity1. Entity1 then transferred \$t to Entity2, which has been and will be paid to claimants covered by the Agreement. Because Entity2 Claimants were required to dismiss their claims before submitting any claim to the Department or Agency, the plaintiffs and defendants in the lawsuit filed a stipulated dismissal with prejudice on Date 3.

Only Entity2 Claimants are entitled to recover under the Act and the Agreement. Of the victims, x are Entity2 Claimants and y are not Entity2 Claimants. The y Victims that are not Entity2 Claimants are entitled to recover only through the JPA.

Department has established procedures to compensate Entity2 Claimants under the Agreement. Entity2 Claimants that were victims of the Incident were required to file a claim with Department and Agency to recover damages for the claims of wrongful death and physical injury.

Entity2 has paid and will pay Entity2 Claimants who were victims with claims arising from the Incident (including those not covered by this ruling), and may pay additional amounts in the future with respect to claims of such victims arising from the Incident. Pursuant to the JPA, as amended, certain victims that were Entity2 Claimants transferred or had transferred to Taxpayer's escrow account amounts of damages that they received or were to receive from Entity2. Beginning on Date 4, Taxpayer distributed amounts received, plus interest that had accrued on such amounts to the Victims according to the agreed allocation formula in the JPA, as amended by the Settlement. Taxpayer expects to distribute additional amounts in the future if and when Entity2 makes additional payments.

## **LAW AND ANALYSIS**

Section 104(a)(2) provides, in general, that gross income does not include the amount of any damages received (whether by suit or agreement) on account of personal physical injuries or physical sickness.

Section 1.104-1(c) of the Income Tax Regulations provides that the term *damages* means an amount received (other than workers' compensation) through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution.

Section 1605 of the Small Business Job Protection Act of 1996 limits the exclusion from gross income provided by § 104(a)(2) to amounts received (other than punitive damages) on account of personal physical injuries or physical sickness. In H.R. Conf. Rep. No. 104-737 at 301 (1996), Congress expressed its intent concerning the treatment of wrongful death damages and emotional distress damages attributable to a physical injury:

[D]amages (other than punitive damages) received on account of a claim of wrongful death continue to be excludable from taxable income as under present law. ... Because all damages received on account of physical injury or physical sickness are excludable from gross income, the exclusion from gross income applies to any damages received based on a claim of emotional distress that is attributable to physical injury or physical sickness.

In this case, each of the Victims is receiving damages because he or she either suffered a cut, scrape, bruise, or other physical injury in the Incident, or inhaled thick smoke and, as a result, suffered smoke inhalation during the Incident. Thus, each of the Victims suffered a personal physical injury or physical sickness as a result of the Incident, and the damages that each received is excludable from his or her income under § 104(a)(2).

Section 6041 requires every person engaged in a trade or business to (1) file an information return for each calendar year in which the person makes in the course of its trade or business payments to another person of fixed and determinable income aggregating \$600 or more, and (2) furnish a copy of the information return to that person. See § 6041(a) and (d) and § 1.6041-1(a)(1) and (a)(2).

Because the damages are excluded from gross income under § 104(a)(2), they are not income under § 6041. Thus, under § 6041, Taxpayer is not required to file information returns or furnish copies of information returns with respect to distributions of damages to Victims.

Section 1441(a) generally provides that a payor of certain items of income (to the extent that such item constitutes gross income from sources within the United States) to a nonresident alien individual is required to deduct and withhold a tax equal to 30% of such income. The items of income subject to § 1441 withholding include fixed or determinable annual or periodical income. See § 1441(b).

Section 1.1441-2(b)(1)(i) generally provides that fixed or determinable annual or periodical income includes all income included in gross income under § 61, but does not include any items of income that are excluded from gross income under a provision of law without regard to the U.S. or foreign status of the owner of the income.

Damages that are excluded from a recipient's gross income under § 104(a)(2) are not subject to withholding under § 1441. Since each distribution of damages to a Victim is excludable from gross income under § 104(a)(2), such distribution is not subject to withholding by Taxpayer under § 1441.

## **CONCLUSIONS**

Based strictly on the information submitted and the representations made, we conclude that the damages received by the Victims pursuant to the JPA, as amended by the Settlement, are excludable from the gross income of the Victims under § 104(a)(2). Thus, Taxpayer is not required to report any such distribution of damages pursuant to § 6041 or to withhold a portion of such distribution under § 1441.

We do not express or imply an opinion on the federal tax consequences of any aspect of these transactions other than those expressed in the immediately preceding paragraph.

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.

The rulings contained in this letter are based upon information and representations that Taxpayer submitted under penalties of perjury. While this office has not verified any of

the material submitted in support of the request for rulings, it is subject to verification on examination.

Taxpayer must attach to any income tax return to which it is relevant a copy of this letter or, if Taxpayer files its returns electronically, a statement providing the date and control number of this letter ruling.

Sincerely,

Michael J. Montemurro  
Branch Chief  
Office of Associate Chief Counsel  
(Income Tax & Accounting)