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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

Refer Reply to:
CC:EBEO:2 - TR-31-231-95

Date: DEC 29 1995

KEY:

Settlement Fund =

Corporation X =

Corporation Y =

date m =

date n =

date o =

date p =

date q =

date r =

b =

c =

d =

e =

year z =

Union =

Dear

This is in reply to your request for a ruling, concerning whether certain payments made from the Settlement Fund give rise to wages to the Plaintiffs for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and Collection of Income Tax at Source on Wages.

230

On date m, Corporation Y entered into a Settlement Agreement with representatives of a class of employees and former employees of Corporation Y ("Plaintiffs"), to settle class action lawsuits filed by the Plaintiffs. The class action litigation which resulted in the Settlement Agreement and the establishment of the Settlement Fund began with the Plaintiffs filing several suits, which were later consolidated. These suits were all based on the same allegation that Corporation Y had operated a

in violation of section 510 of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. 1140, and other law.

The Settlement Agreement provides for the creation of a settlement fund ("Settlement Fund") in the amount of b dollars "in full and complete settlement of all claims" alleged by the Plaintiffs in the class action litigation. With limited exceptions, the amount of b dollars in settlement payments made on behalf of Corporation Y to the Settlement Fund constitutes Corporation Y's sole liability to the Plaintiffs in connection with the settlement.

The Settlement Agreement provides that "Plaintiffs' attorneys' fees and Plaintiffs' costs and expenses of this litigation, as approved by the Court, and all expenses in connection with this settlement, including costs of class notice, costs of obtaining a revenue ruling and determining any taxes owed as provided in Paragraph 4, costs of establishing and administering a pension plan as provided in Paragraph 6, and all other costs of implementing and administering the settlement, and any other items, all as approved by the Court, shall be paid from the Settlement Fund."

Paragraph 4 of the Settlement Agreement provides that "[a]ll federal, state, and local taxes imposed with respect to income earned by, or property of, the Settlement Fund, and all federal, state and local withholding, employment, unemployment, excise or similar taxes that may be imposed with respect to distributions from the Settlement Fund (including without limitation FICA, FUTA, ... [state unemployment tax] and, in each instance, both the class members' and Defendants' share of all taxes), shall be paid from the Settlement Fund; except that income taxes payable with respect to interest on, or earnings of, the Settlement Fund prior to the final distribution described in Paragraph 5 shall be paid by Defendants."[1]

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[1]It is the Service's litigating position that payments made from the Settlement Fund directly to the Plaintiffs are includible in gross income and are wages subject to federal

231

The first amendment to the Settlement Agreement provides in paragraph 1 that the Special Master shall have the authority to approve and pay from the Settlement Fund all costs and expenses of administering and implementing the settlement. Furthermore, no withdrawal, transfer, or other action may be taken or made with respect to the assets of the Settlement Fund without the signature and approval of the Special Master.

In accordance with paragraph 3 of the Settlement Agreement, the court issued a decision and order on date n, as amended on date o, that awarded attorneys' fees and interest thereon in the total amount of approximately c dollars to Plaintiffs' counsel for their services through date p. Pursuant to an order dated date q, the court approved an interim payment of attorneys' fees in the amount of d dollars. By a court order dated date r, an additional interim payment of Plaintiffs' attorneys' fees in the amount of e dollars was approved by the court and paid from the Settlement Fund. It is anticipated that the balance of the attorneys' fees remaining due in accordance with the date o court order, after reduction for the interim payments, will be paid in year z.

Pursuant to paragraph 3 of the Settlement Agreement, the court, acting through the Special Master, as contemplated by the first amendment to the Agreement, has also approved payments of attorneys' fees for services rendered by Plaintiffs' counsel after date p.

In addition to the payment of the attorneys' fees, the Settlement Fund paid amounts that you have described as administrative expenses of the Settlement Fund. These amounts include payments to tax attorneys, accountants, printers, and other service providers for the printing and mailing of the Plan of Distribution, the calculation, preparation, and mailing of distributions to Plaintiffs, and other costs. These expenses also include amounts paid pursuant to paragraph 4(c) of the Agreement to tax attorneys to "seek a ruling from the Internal Revenue Service regarding the federal income, withholding, employment or other taxes (including without limitation FICA and FUTA) that may be due with respect to" the awards paid directly to Plaintiffs.

The amounts paid by the Settlement Fund include amounts paid to reimburse the Union for costs, such as deposition expenses, travel expenses, and expert witness fees, which the Union had incurred in supporting the litigation. In addition, the Settlement Fund has reimbursed the Plaintiffs' counsel for

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employment taxes.

232

expenses incurred for travel, photocopying, telephone, postage, and similar items. Each of these payments of administrative expenses was made only after review and approval by the Special Master on behalf of the court in accordance with the terms of the Settlement Agreement, as amended.

Under section 3402(a) of the Internal Revenue Code, every employer making a payment of wages must deduct and withhold federal income tax from such wages. For federal income tax withholding purposes, "wages" are defined in section 3401(a) as all remuneration for services performed by an employee for his or her employer, with certain specified exceptions.

Sections 3101 and 3111 of the Code impose FICA taxes with respect to wages. Section 3301 imposes FUTA tax on employers with respect to wages. For purposes of the FICA and the FUTA, "wages" are generally defined in sections 3121(a) and 3306(b), respectively, as all remuneration for employment, with certain specified exceptions.

Rev. Rul. 80-364, 1980-2 C.B. 294, concerns the issue of whether interest and attorneys' fees in connection with claims for back pay are wages for federal employment tax purposes. In Situation 3 of the ruling, a union filed claims on behalf of its members against a company because of a breach of a collective bargaining agreement. Subsequently, the union and the company entered into a settlement agreement, later approved by a federal district court, that provided that the company would pay the union 40x dollars in full settlement of all claims. The union paid 6x dollars of the settlement for attorney's fees and distributed 34x dollars to the employees for back pay owed to them.

In Situation 3, Rev. Rul. 80-364 concludes that the amount of the settlement paid by the union for attorney's fees is not remuneration to the individual employees and, therefore, is not wages for purposes of federal employment taxes. The ruling states, in part, that the attorney's fees portion of the settlement is a reimbursement for expenses incurred by the union to enforce the collective bargaining agreement.

We believe that the position of the Settlement Fund with respect to the payments of attorneys' fees can be analogized to the position of the union in Situation 3 in Rev. Rul. 80-364. Accordingly, we conclude as follows:

> The Plaintiffs' attorneys' fees paid pursuant to the court orders and otherwise approved by the court and the administrative expenses incurred in connection with the litigation or otherwise incurred by the Settlement Fund do

not give rise to wages to the Plaintiffs for purposes of the FICA, the FUTA, or federal income tax withholding under sections 3121(a), 3306(b), and 3401(a), respectively. Further, no information reporting is required that would report these payments as having been made to the Plaintiffs.

No implication should be drawn from this ruling as to any other tax issue relating to the above transaction. No opinion is expressed whether payments by the Settlement Fund to individuals or entities for services provided to the Settlement Fund are wages for federal employment tax purposes to the service providers. Also, no ruling was sought on the income tax treatment of any amounts paid by the Settlement Fund and no opinion is expressed on that issue.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Jerry E. Holmes

JERRY E. HOLMES
Chief, Branch 2
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure
Copy for section 6110 purposes

234