



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

SMALL BUSINESS / SELF-EMPLOYED DIVISION

On December 22, 2006, the Ninth Circuit Court of Appeals issued a ruling regarding the award of punitive damages to litigants affected by the 1989 *Exxon Valdez* oil spill. The IRS is providing the following information to help recipients of this award understand the federal income tax issues related to court-awarded damages.

Taxability of the Award

Punitive damages are taxable income. The entire amount must be claimed on your tax return for the tax year in which the proceeds are paid, even if some or all of the money is levied by the IRS for payment of back taxes or garnished for another purpose, such as payment to child support authorities. Thus, if your award is \$100,000, and \$50,000 is paid to the IRS for back taxes because of a levy, and the other \$50,000 to child support authorities to pay back child support, you still owe taxes in the year of receipt on the full \$100,000 as if you had received all of it.

Withholding. It is not generally required for the Exxon Qualified Settlement Fund (EQSF) to withhold income taxes from your award. However, if the EQSF has not received a signed Form W-9 from you, it will withhold 28 percent of your award and immediately forward it to the IRS. You will include this amount as withholding in the "payments" section of your federal income tax return.

The EQSF Administrator is permitted to arrange for *voluntary* withholding to recipients who indicate their interest by completing the enclosed form, "Authorization for Estimated Tax Payment to IRS." Claimants have the option of specifying a percentage of the proceeds or a dollar amount. To help calculate the appropriate percentage or amount, you can use the worksheet in Form 1040ES, Estimated Tax for Individuals, which is available at www.irs.gov/formspubs or by calling 1-800-829-3676. Please note that the 2008 Form 1040ES is not yet available; the 2007 worksheet will help you calculate a reasonable estimate of your tax liability on the award.

Estimated Taxes. If the EQSF does not withhold tax from your award – either the mandatory 28 percent if you don't provide a signed Form W-9 or an amount of withholding you voluntarily request – you need to carefully consider whether you have an obligation to make estimated tax payments. You must pay estimated tax for 2008 if both of the following apply:

1. You expect to owe at least \$1,000 in tax for 2008, after subtracting your withholding and credits; and
2. You expect your withholding and credits to be less than the smaller of:
 - a. 90 percent of the tax to be shown on your 2008 tax return, or
 - b. 100 percent of the tax shown on your 2007 tax return.

For more information on estimated tax payments, go to www.IRS.gov/formspubs to download Publication 505, Estimated Tax Payments, and Form 1040 ES and instruction. To request a copy by mail, call 1-800-829-3676. For general tax information, please visit the IRS.gov website.

If You Owe Back Taxes

If you have received a Final Notice, Notice of Intent to Levy, or Letter 3174, you may contact the IRS representative assigned to your case to resolve your account or get answers to questions.

If you have received an IRS Notice of Levy attaching your Exxon Valdez litigation proceeds and believe it is in error, you should contact the IRS representative whose name and number is listed on the notice, or call (907) 271-6072 with any questions on an IRS levy of your Exxon Valdez litigation proceeds.

If you are unable to pay your account in full and a Notice of Levy was not previously issued, one may be issued for any unpaid taxes. However, to avoid any other collection actions on your account, you should attempt to resolve your account by other means, such as an installment agreement. The levy will remain in effect until your account is paid or upon final distribution of court-ordered payments, whichever occurs first. If you have a question regarding the steps the IRS may take to collect your balance due account, go to www.IRS.gov/formspubs to download Publication 594, The IRS Collection Process. To ask specific questions, call the Internal Revenue Service at (907) 271-6072.

If you have assigned part of your proceeds to someone else, or if another creditor has served an attachment against your proceeds, you should promptly notify the IRS by calling (907) 271-6894. This will enable the IRS and the competing assignee or creditor(s) to determine the relative priorities of their interests before your distribution becomes available and prevent any unnecessary delay in the distribution of excess proceeds to you.

If, as a result of the IRS Notice of Levy, you are experiencing economic harm or a systemic problem, or are seeking help in resolving tax problems that have not been resolved through normal channels, you may be eligible for Taxpayer Advocate Service (TAS) assistance. You can reach TAS by calling the Alaska TAS office at 1-866-490-5449, or the TAS toll-free case intake line at 1-877-275-8271 or TTY/TDD 1-800-829-4059.

Low Income Taxpayer Clinics (LITCs) are independent organizations that provide low income taxpayers with representation in federal tax controversies with the IRS for free or for a nominal charge. The clinics also provide tax education and outreach for taxpayers with limited English proficiency or who speak English as a second language. Publication 4134, Low Income Taxpayer Clinic List, provides information on clinics in your area. It is available at www.irs.gov or your local IRS office.