Instructions for Form 1120-SF

(Rev. December 2011)

U.S. Income Tax Return for Settlement Funds

Department of the Treasury
Internal Revenue Service

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

- Beginning January 1, 2011, settlement funds must use electronic funds transfers to make all federal tax deposits (such as deposits of employment tax, excise tax, and corporate income tax). Forms 8109 and 8109-B, Federal Tax Coupon, cannot be used after December 31, 2010. See *Electronic Deposit Requirement* below.
- The IRS has created a page on IRS.gov for Form 1120-SF and its instructions, at *www.irs.gov/form1120sf*. Information about any future developments affecting Form 1120-SF (such as legislation enacted after we release it) will be posted on that page.

General Instructions

Purpose of Form

Use Form 1120-SF, U.S. Income Tax Return for Settlement Funds, to report transfers received, income earned, deductions claimed, distributions made, and to figure the income tax liability of a designated or qualified settlement fund.

Who Must File

All section 468B designated and qualified settlement funds must file an annual income tax return on Form 1120-SF.

When To File

Generally, a settlement fund must file its income tax return by the 15th day of the 3rd month after the end of its tax year.

If the due date falls on a Saturday, Sunday, or legal holiday, the fund may file on the next business day.

Private delivery services. Settlement funds can use certain private delivery services designated by the IRS to meet the timely mailing as "timely filing/paying" rule for tax returns and payments. See the Instructions for Form 1120, U.S. Corporation Income Tax Return, for details.

CAUTION *Private delivery services cannot deliver items to P.O. boxes. The fund must use the U.S. Postal Service to mail any items to an IRS P.O. box address.*

Extension of time to file. File Form 7004, Application for Automatic 6-Month Extension of Time To File Certain Business Income Tax, Information, and Other Returns, to request a 6-month extension of time to file. Generally, file Form 7004 by the regular due date of the return.

Who Must Sign

The return must be signed and dated by the administrator of the fund.

If an employee of the fund completes Form 1120-SF, the paid preparer's space should remain blank. Anyone who prepares Form 1120-SF but does not charge the fund should not complete that section. Generally, anyone who is paid to prepare the return must sign it and fill in the "Paid Preparer Use Only" area.

The paid preparer must complete the required preparer information and:

- Sign the return in the space provided for the preparer's signature.
- Give a copy of the return to the administrator.

Note. A paid preparer may sign original or amended returns by rubber stamp, mechanical device, or computer software program.

Paid Preparer Authorization

If the fund wants to allow the IRS to discuss its tax return with the paid preparer who signed it, check the "Yes" box in the signature area of the return. This authorization applies only to the individual whose signature appears in the "Paid Preparer Use Only" section of the fund's return. It does not apply to the firm, if any, shown in that section.

If the "Yes" box is checked, the fund is authorizing the IRS to call the paid preparer to answer any questions that may arise during the processing of its return. The fund is also authorizing the paid preparer to:

- Give the IRS any information that is missing from the return,
- Call the IRS for information about the processing of the return or the status of any related refund or payment(s), and
- Respond to certain IRS notices about math errors, offsets, and return preparation.

The fund is not authorizing the paid preparer to receive any refund check, bind the fund to anything (including any additional tax liability), or otherwise represent the fund before the IRS.

The authorization will automatically end no later than the due date (excluding extensions) for filing the fund's tax return. If the fund wants to expand the paid preparer's authorization or revoke the authorization before it ends, see Publication 947, Practice Before the IRS and Power of Attorney.

Assembling the Return

To ensure that the fund's tax return is processed correctly, attach all schedules in alphabetical order and other forms in numerical order after Form 1120-SF.

Complete every applicable entry space on Form 1120-SF. Do not write "See Attached" instead of completing the entry spaces. If more space is needed on the forms or schedules, attach separate sheets using the same size and format as the printed forms. If there are supporting statements and attachments, arrange them in the same order as the schedules or forms they support and attach them last. Show the totals on the printed forms. Enter the fund's name and employer identification number (EIN) on each supporting statement or attachment.

Tax Payments

The fund must pay any tax due in full no later than the 15th day of the 3rd month after the end of the tax year.

Electronic Deposit Requirement

Beginning January 1, 2011, funds must use electronic funds transfers to make all federal tax deposits (such as deposits of employment, excise, and income tax). Forms 8109 and 8109-B, Federal Tax Coupon, cannot be used after December 31, 2010. Generally, electronic funds transfers are made using the Electronic Federal Tax Payment System (EFTPS). However, if the fund does not want to use EFTPS, it can arrange for its tax professional, financial institution, payroll service, or other trusted third party to make deposits on its behalf. Also, it may arrange for its financial institution to initiate a same-day tax wire payment (discussed below) on its behalf. EFTPS is a free service provided by the Department of the Treasury. Services provided by a tax professional, financial institution, payroll service, or other third party may have a fee.

To get more information about EFTPS or to enroll in EFTPS, visit *www.eftps.gov,* or call 1-800-555-4477. Additional information about EFTPS is also available in Pub. 966, The Secure Way to Pay Your Federal Taxes.

Depositing on time. For deposits made by EFTPS to be on time, the fund must initiate the deposit by 8 p.m. Eastern time the day before the date the deposit is due. If the fund uses a third party to make deposits on its behalf, they may have different cutoff times.

Same-day wire payment option. If the fund fails to initiate a deposit transaction on EFTPS by 8 p.m. Eastern time the day before the date a deposit is due, it can still make the deposit on time by using the Federal Tax Application (FTA). Before using the same-day wire payment option, the fund will need to make arrangements with its

Where To File

File the fund's return at the applicable IRS address listed below.

If the fund's principal business, office, or agency is located in:	And the total assets at the end of the tax year (Form 1120-SF, Schedule L, line 6, column (b)) are:	Use the following address:
Connecticut, Delaware, District of Columbia, Georgia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Hampshire, New Jersey, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Vermont, Virginia, West Virginia, Wisconsin	Less than $10 million	Department of the Treasury Internal Revenue Service Center Cincinnati, OH 45999-0012
	$10 million or more	Department of the Treasury Internal Revenue Service Center Ogden, UT 84201-0012
Alabama, Alaska, Arizona, Arkansas, California, Colorado, Florida, Hawaii, Idaho, Iowa, Kansas, Louisiana, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, South Dakota, Texas, Utah, Washington, Wyoming	Any amount	Department of the Treasury Internal Revenue Service Center Ogden, UT 84201-0012
A foreign country or U.S. possession	Any Amount	Internal Revenue Service Center P.O. Box 409101 Ogden, UT 84409

financial institution ahead of time. Please check with the financial institution regarding availability, deadlines, and costs. To learn more about making a same-day wire payment and download the Same-Day Payment Worksheet, visit *www.eftps.gov.*

Estimated Tax Payments

Generally, the following rules apply to the fund's payments of estimated tax.

- A fund must make installment payments of estimated tax if it expects its total tax for the year (less applicable credits) to be $500 or more.
- The installments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year. If any date falls on a Saturday, Sunday, or legal holiday, the installment is due on the next business day.
- The fund must use electronic fund transfers to make installment payments of estimated tax.
- Use Form 1120-W, Estimated Tax for Corporations, as a worksheet to compute estimated tax.
- If the fund overpaid estimated tax, it may be able to get a quick refund by filing Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax.

For more information on estimated tax payments, including penalties that apply if the fund fails to make required payments, see the instructions for line 17.

Interest and Penalties

Interest. Interest is charged on taxes paid late even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, substantial valuation misstatements, substantial understatements of tax, and reportable transaction understatements from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

Late filing of return. A fund that does not file its tax return by the due date, including extensions, may be penalized 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is over 60 days late is the smaller of the tax due or $135. The penalty will not be imposed if the fund can show that the failure to file on time was due to reasonable cause. A fund that does not pay the tax when due generally may be penalized ½ of 1% of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax. The penalty will not be imposed if the fund can show that the failure to pay on time was due to reasonable cause.

Late payment of tax. A fund that does not pay the tax when due generally may be penalized ½ of 1% of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax. The penalty will not be imposed if the fund can show that the failure to pay on time was due to reasonable cause.

Reasonable cause determinations. If the fund receives a notice about interest and penalties after it files its return, send the IRS an explanation, and we will determine if the fund meets the reasonable cause criteria. **Do not** attach an explanation when the fund files its return.

The trust fund recovery penalty. This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid. The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the Instructions for Form 720 or Publication 15 (Circular E), Employer's Tax Guide, for details, including the definition of responsible persons.

Other penalties. Other penalties can be imposed for negligence, substantial understatement of tax, reportable transaction understatements, and fraud. See sections 6662, 6662A, and 6663.

Tax Year and Accounting Method

A designated or qualified settlement fund's tax year is the calendar year and the fund must use the accrual method of accounting.

Rounding Off to Whole Dollars

The fund may round off cents to whole dollars on its return and schedules. If the fund does round to whole dollars, it must round all amounts. To round, drop amounts under 50 cents and increase amounts from 50 cents to 99 cents to the next dollar. For example, $1.39 becomes $1 and $2.50 becomes $3.

If two or more amounts must be added to figure the amount to enter on a line, include cents when adding the amounts and round off only the total.

Recordkeeping

Keep the fund's records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Usually, records that support an item of income, deduction, or credit on the return must be kept for 3 years from the date the return is due or filed, whichever is later. Keep records that verify the fund's basis in property for as long as they are needed to figure the basis of the original or replacement property.

The fund should keep copies of all filed returns. They help in preparing future and amended returns.

Additional Information

See the Instructions for Form 1120 and Publication 542, Corporations, for more information about corporations including additional forms the fund may need to file and how to get forms and publications.

Definitions

Qualified Settlement Fund

A fund, account, or trust ("a fund") is a qualified settlement fund if it meets the following requirements:

- Governmental order or approval requirement,
- Resolve or satisfy requirement, and
- Segregation requirement.

Governmental order or approval requirement. To meet this requirement, the fund must be ordered by, or approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing, and it must be subject to the continuing jurisdiction of that governmental authority.

A fund is ordered by or approved by a governmental authority when the authority issues its initial or preliminary order to establish, or grants its initial or preliminary approval of, the fund even if that order or approval may be subject to review or revision. Generally, a governmental authority's order or approval has no retroactive effect and does not permit a fund to be a qualified settlement fund prior to the date the order is issued or the approval is granted. However, see *Relation-back rule* below.

Arbitration panels. An arbitration award that orders the establishment of, or approves, a fund is an order or approval of a governmental authority if:

- The arbitration award is judicially enforceable;
- The arbitration award is issued following a bona fide arbitration proceeding in accordance with rules approved by a governmental authority (such as self-regulatory organization-administered arbitration proceedings in the securities industry); and
- The fund is subject to the continuing jurisdiction of the arbitration panel, the court of law that has jurisdiction to enforce the arbitration award, or the governmental authority that approved the rules of the arbitration proceedings.

Resolve or satisfy requirement. To meet this requirement, a fund must be established to resolve or satisfy one or more contested or uncontested claims that have resulted, or may result, from an event (or a series of related events) that has occurred and that has given rise to at least one claim asserting liability:

- Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA); as amended for settlement funds created before May 18, 2006.
- Arising out of a tort, breach of contract, or violation of law; or
- Designated by the IRS in a revenue ruling or revenue procedure.

Generally, a fund does not meet the resolve or satisfy requirement if it is established to resolve or satisfy a liability to provide property or services unless the transferor's obligation to provide property or services is extinguished by a transfer or transfers to the fund.

Note. Settlement funds created after May 17, 2006, for the purpose of resolving or satisfying liabilities under the CERCLA are exempt from tax.

Segregation requirement. To meet this requirement, the fund must (a) be a trust under applicable state law or (b) keep its assets segregated from other assets of the transferor (and related persons). For example, cash held by a transferor in a separate bank account satisfies the segregation requirement.

Classification of fund prior to meeting all three requirements. If a fund meets the resolve or satisfy requirement, the assets of the fund are treated as owned by the transferor of those assets until the fund also meets the governmental order and the segregation requirements. On the day the fund meets all three requirements, the transferor is treated as transferring the assets to a qualified settlement fund.

Relation-back rule. If a fund meets the resolve or satisfy requirement and the segregation requirement before it meets the governmental order or approval requirement, the transferor and the administrator (defined above) may jointly elect the relation-back election (defined below) to treat the fund as coming into existence as a qualified settlement fund on the later of (a) the date the fund meets the resolve or satisfy requirement and the segregation requirement or (b) January 1 of the calendar year in which all three requirements are satisfied.

If a relation-back election is made, the assets held by the fund on the date the qualified settlement fund is treated as coming into existence are treated as transferred to the qualified settlement fund on that date.

Relation-back election. Make the relation-back election by attaching a copy of the election statement to Form 1120-SF for the tax year in which the qualified settlement fund is treated as coming into existence. The statement must be signed by each transferor and the administrator. File Form 1120-SF and the election statement by the due date of Form 1120-SF, including extensions. The election statement must contain the following,

- The words "Regulations section 1.468B-1 Relation-Back Election" at the top of the first page.
- The name, address, and identifying number of each transferor.
- The name, address, and EIN of the qualified settlement fund.
- The date on which the qualified settlement fund is treated as coming into existence.
- A schedule describing each asset treated as transferred to the fund on the date the fund is treated as coming into existence. The schedule of assets does not have to identify the amount of cash or the property transferred by a particular transferor.

Qualified settlement fund treated as a corporation. Except as otherwise provided in Regulations section 1.468B-5(b), for purposes of subtitle F of the Internal Revenue Code, a qualified settlement fund is treated as a corporation and any tax imposed under Regulations section 1.468B-2(a) is treated as a tax imposed by section 11. See Regulations section 1.468B-2(k) for more information.

Designated Settlement Fund

A fund, account, or trust is a designated settlement fund if it meets the following requirements:

- It is established by a court order and completely extinguishes the taxpayer's tort liability.
- No amounts may be transferred to it other than in the form of a qualified payment (defined below).
- It must be administered by persons, a majority of whom are independent of the taxpayer.
- It is established for the principal purpose of resolving and satisfying present and future claims against the taxpayer arising out of personal injury, death, or property.
- The taxpayer may not hold any beneficial interest in the income or corpus of it.
- The taxpayer elects to have it treated as a designated settlement fund.

Qualified payment. A qualified payment is any money or property that is transferred to a designated settlement fund under a court order other than:

- Any amount that may be transferred from the fund to the taxpayer (or any related person).
- The transfer of any stock or indebtedness of the taxpayer (or any related person).

Important. A designated settlement fund is taxed in the same manner as a qualified settlement fund. In addition, if a fund does not meet the requirements of a designated settlement fund but does meet the requirements of a qualified settlement fund, the fund is treated as a qualified settlement fund.

Other Definitions

Administrator. An administrator, which may include a trustee if the designated or qualified settlement fund is a trust, is (in order of priority):

- The person designated or approved by the governmental authority that ordered or approved the fund.
- The person designated in the escrow agreement, settlement agreement, or other similar agreement governing the fund.
- The escrow agent, custodian, or other person in possession of the fund's assets.
- The transferor or, if there are multiple transferors, all of the transferors unless an agreement is signed by all of the transferors that designates a single transferor as the administrator.

Transferor. A transferor is a person who transfers (or on whose behalf an insurer or other person transfers) money or property to a settlement fund to resolve or satisfy claims against that person.

Related person. A related person is any person who is related to the transferor within the meaning of section 267(b) or section 707(b)(1).

Specific Instructions

Period Covered

A designated or qualified settlement fund's tax year is the calendar year.

Address

Include the suite, room, or other unit number after the street address. If the Post Office does not deliver mail to the street address and the fund or the administrator has a P.O. box, show the box number instead.

Employer Identification Number (EIN)

Enter the fund's EIN. If the fund does not have an EIN, it must apply for one. An EIN may be applied for online, by telephone, by fax, or by mail, depending on how soon the fund needs to use the EIN. Use Form SS-4, Application for Employer Identification Number.

If the fund has not received its EIN by the time the return is due, write "Applied for" in the space for the EIN. For more details, see the Instructions for Form SS-4.

Final Return, Name Change, Address Change, or Amended Return

Indicate a final return, name change, address change, or amended return by checking the appropriate box. If a change in address occurs after the return is filed, use Form 8822, Change of Address, to notify the IRS of the new address.

Part I. Income and Deductions

Income

Note. Amounts transferred to the fund by or on behalf of a transferor are generally excluded from income.

Line 1. Taxable interest. Enter total taxable interest received or accrued during the tax year, including original issue discount. Do not include any tax-exempt interest. Do not offset interest expense against interest income.

Note. Report tax-exempt interest on line 2 of Additional Information (on page 2 of Form 1120-SF).

Line 3. Capital gain net income. Every sale or exchange of a capital asset must be reported in detail on Schedule D (Form 1120), Capital Gains and Losses, even if there is no gain or loss.

Line 5. Other income. Enter any other taxable income not reported on lines 1 through 4. List the type and amount of income on an attached schedule. If the fund has only one item of other income, describe it in parentheses on the dotted line next to the entry space for line 5.

Deductions

Do not deduct:

- Expenses allocable to tax-exempt income (see section 265);
- Payments of claims made by the fund; and
- Expenses incurred by, or on behalf of, claimants or transferors.

Line 11. Other deductions. Enter the total of other deductions not entered on lines 7 through 10. List the type and amount of deduction on an attached schedule. If the fund has only one item of other deduction, describe it in parentheses on the dotted line next to the entry space for line 11.

Line 12. Net operating loss deduction (NOL). Enter the total NOL carryovers from prior tax years, but do not enter more than the fund's taxable income. See Regulations section 1.468B-2(b)(4) for details.

Part II. Tax Computation

Line 14. Modified gross income. Modified gross income of a designated or qualified settlement fund is its gross income, as defined in section 61, computed with certain modifications. See Regulations section 1.468B-2(b) for more information.

Line 16. Credits and payments. Generally, no credits or payments are allowed other than those on lines 16a through 16e.

Line 17. Estimated tax penalty. A fund that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a fund is subject to the penalty if its tax liability is $500 or more and it did not timely pay the smaller of:

- Its current year tax liability or
- Its prior year's tax.

See section 6655 for details and exceptions, including special rules for large funds.

Use Form 2220, Underpayment of Estimated Tax by Corporations, to see if the fund owes a penalty and to figure the amount of the penalty. Generally, the fund does not have to file this form because the IRS can figure the amount of any penalty and bill the fund for it. See Form 2220 for other information that may apply.

If Form 2220 is attached, check the box on line 17 and enter the amount of any penalty on that line.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	18 hr., 24 min.
Learning about the law or the form	2 hr., 49 min.
Preparing the form	5 hr., 6 min.
Copying, assembling, and sending the form to the IRS	32 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:M:S, 1111 Constitution Ave., NW, IR-6526, Washington, DC 20224.

Do not send the tax form to this address. Instead, see *Where To File,* earlier.