

Internal Revenue Service

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In Re:

Refer Reply To:

CC:ITA:B06 – PLR-130680-04

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Taxpayer =
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Dear _____ :

This is in reply to a request for ruling dated June 2, 2004, concerning the creation of a trust pursuant to a plan of reorganization under chapter 11 of the U.S. Bankruptcy Code (the "Plan") established to satisfy certain asbestos-related personal injury claims brought against Taxpayer. Specifically, you have requested the following rulings:

(1) As of the effective date of the establishment of the trust (the "successor trust"), the successor trust will be treated as a qualified settlement fund under section 1.468B-1(c) of the Income Tax Regulations;

(2) The assets (the "trust assets") transferred to the successor trust as contemplated by the Plan will be excluded from the gross income of the successor trust pursuant to section 1.468B-2(b)(1); and

(3) Taxpayer may deduct its payments to the successor trust in the year of payment in accordance with sections 162, 461(h), and 468B(a) of the Internal Revenue Code. Pursuant to section 1.468B-3(c)(3), Taxpayer will be entitled to a deduction with

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respect to its promissory note transferred to the successor trust in the year payments are made on the promissory note, not the year of delivery of the promissory note to the successor trust.

FACTS

Taxpayer is a State A corporation with offices and warehouses located throughout the state. Taxpayer is a distributor and fabricator of gaskets and packings for general industrial use and application. Since Year 1, Taxpayer has been involved in a number of asbestos-related lawsuits and tort claims for personal injury, death and disease as a result of exposure to asbestos or asbestos-related products. As of Date 1, approximately b cases were pending in a number of jurisdictions involving some c claimants (“Asbestos Claimants”).

On Date 2, Taxpayer and certain Asbestos Claimants reached a global settlement, which included filing the Plan under chapter 11 of the Bankruptcy Code, and executing a settlement agreement, a security and assignment agreement, and a collateral trust agreement creating a trust for the benefit of the Asbestos Claimants (the “collateral trust”).

The collateral trust was established for the purpose of holding a security interest in certain insurance proceeds (the “collateral”) and to use such collateral to pay asbestos-related claims, as well as certain reimbursable transaction costs incurred by Taxpayer in connection with settling all of the asbestos-related claims and the chapter 11 reorganization.

Pursuant to the Plan, the successor trust will be established after the effective date of the Plan for the benefit of the Asbestos Claimants and unknown asbestos claimants and will be responsible for satisfying all of the asbestos claims of Taxpayer. The successor trust will be established as a trust under the laws of State A. Under the Plan, once the successor trust becomes effective the collateral trust will transfer all of its rights and trust assets to the successor trust and terminate. The successor trust will preserve the rights of the collateral trust beneficiaries as stated in the collateral trust agreement. All asbestos claims will be assumed by and transferred to the successor trust. The successor trust will assume and be solely responsible for all of the asbestos claims of Taxpayer.

In addition to certain insurance proceeds transferred from the collateral trust, the successor trust’s assets will consist of Taxpayer’s promissory note in the amount of \$ d. The promissory note will be payable to the successor trust over a period of e years, commencing at the end of the month in which the effective date occurs. The successor trust will be responsible for all trust expenses, including administrative costs and legal, accounting and other professional fees incurred in connection with its purposes and

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activities. The successor trust also will indemnify and reimburse Taxpayer for certain costs and expenses related to asbestos claims (except for reimbursable transaction costs that total less than \$ f), including any expenses, costs and fees, judgments, settlements or other liabilities arising from or incurred in connection with any action related to an asbestos claim. The Plan provides that the successor trust will become effective on the “effective date,” as defined by the Plan. Under the Plan, the “effective date” means the first business day immediately following the first day upon which all of the conditions to occurrence of the “effective date” contained in the Plan have been satisfied or waived.

Taxpayer represents that the successor trust will be formed for the purpose of facilitating Taxpayer’s bankruptcy and the settlement and payment of the asbestos claims brought against it. Taxpayer further represents that by utilizing the successor trust as a separate legal entity, Taxpayer will be able to assign the trust assets to the successor trust in order to satisfy the asbestos claims. Pursuant to the Plan, Taxpayer’s liability for the asbestos claims will be assumed by the successor trust and barred as against Taxpayer. Finally, Taxpayer represents that the successor trust will enable Taxpayer to reorganize and emerge from bankruptcy free from the asbestos claims.

APPLICABLE LAW

Section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies the following requirements of section 1.468B-1(c):

(1) it is established pursuant to an order of, or is 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 is subject to the continuing jurisdiction of that governmental authority;

(2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability--

(i) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA); or

(ii) arising out of a tort, breach of contract, or violation of law; or

(iii) designated by the Commissioner in a revenue ruling or revenue procedure; and

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(3) it is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

Section 1.468B-1(h)(2) provides that if a fund, account, or trust is established to resolve or satisfy claims described in section 1.468-1(c)(2) as well as other types of claims (*i.e.*, non-allowable claims) arising from the same event or related series of events, the fund is a qualified settlement fund. However, under section 1.468B-3(c), economic performance does not occur with respect to transfers to the qualified settlement fund for non-allowable claims.

Section 1.468B-2(b)(1) provides that in general, amounts transferred to the qualified settlement fund by, or on behalf of, a transferor to resolve or satisfy a liability for which the fund is established are excluded from gross income. However, dividends on stock of a transferor (or a related person), interest on debt of a transferor (or a related) and payments in compensation for late or delayed transfers, are not excluded from gross income.

Section 162(a) provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 461(h)(1) provides that in determining whether an amount has been incurred with respect to any item during the taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

Section 461(h)(2)(C)(ii) provides that if the liability of the taxpayer requires a payment to another person and arises out of any tort, economic performance occurs as the payments to such person are made.

Section 1.468B-3(c)(1) provides that for purposes of section 461(h), economic performance occurs with respect to a liability described in section 1.468B-1(c)(2) to the extent the transferor makes a transfer to a qualified settlement fund to resolve or satisfy the liability.

Section 1.468B-3(c)(3) provides that economic performance does not occur when a transferor transfers to a qualified settlement fund its debt (or the debt of a related person). Instead, economic performance occurs as the transferor (or related person) makes principal payments on the debt.

Section 1.468B-3(d) provides that no deduction is allowed to a transferor for a transfer to a qualified settlement fund to the extent the transferred amounts represent amounts received from the settlement of an insurance claim and are excludable from

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gross income. If the settlement of an insurance claim occurs after a transferor makes a transfer to a qualified settlement fund for which a deduction has been taken, the transferor must include in income the amounts received from the settlement of the insurance claim to the extent of the deduction.

RULING

Based solely on the information provided and representations made, we rule that the successor trust, once effective, will be a qualified settlement fund under section 1.468B-1(c) because the three requirements of that section are satisfied. First, the successor trust is established pursuant to an order of the bankruptcy court and is subject to that court's continuing jurisdiction. Second, the successor trust is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from a related series of events (i.e., the distribution and fabrication of products containing asbestos) and that have given rise to at least one claim asserting tort liability for personal injury or death. Third, the successor trust is a trust under the laws of State A. The fact that the successor trust will be used to pay certain non-allowable claims (i.e., certain reimbursable transaction costs, indemnity payments, and similar costs discussed hereinabove) does not invalidate its status as a qualified settlement fund because such non-allowable claims arise from the same related series of events.

Further, the trust assets transferred to the successor trust as contemplated by the Plan will be excluded from the gross income of the successor trust pursuant to section 1.468B-2(b)(1) because the trust assets are being transferred to the successor trust by, or on behalf of, Taxpayer to resolve or satisfy Taxpayer's asbestos claims and related liability for which the successor trust is established.

Finally, to the extent that the requirements of sections 162 and 461(h) are otherwise met, Taxpayer may deduct its payments to the successor trust in the year of payment. However, with respect to the promissory note transferred to the successor trust by Taxpayer, Taxpayer will be entitled to a deduction in the year payments are made on the promissory note, not the year of delivery of the promissory note to the successor trust. Likewise, with respect to the insurance proceeds referred to herein, no deduction will be allowed to Taxpayer for a transfer to the successor trust to the extent the insurance proceeds are excludable from Taxpayer's gross income.

Except as specifically set forth above, no opinion is expressed regarding the federal tax treatment of this transaction.

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

Sincerely,

Thomas A. Luxner
Branch Chief
Office of Associate Chief Counsel (Income
Tax and Accounting)