

Internal Revenue Service

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Date:

August 17, 2005

Legend:

Company	=
Fund	=
Year 1	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
<u>X</u>	=
<u>Y</u>	=
<u>A</u>	=
<u>B</u>	=

Dear :

This is in reply to a request for rulings dated May 24, 2005, and supplemental correspondence dated July 21, 2005, concerning the establishment of Fund pursuant to an order of the bankruptcy court in connection with a proposed plan of reorganization under Chapter 11 of the U. S. Bankruptcy Code to resolve or satisfy certain asbestos-related personal injury and related liability claims brought against Company. Specifically, you have requested rulings that:

(1) Fund, once effective, will be a qualified settlement fund under section 1.468B-1(c) of the Income Tax Regulations; and

(2) to the extent that the requirements of sections 162 and 461(h) of the Internal Revenue Code are otherwise met, Company may deduct the amount of cash and the fair market value of other property transferred to Fund in the year of transfer, except to the extent the amounts transferred to Fund by Company represent amounts received

from the settlement of an insurance claim and are excludable from Company's gross income.

FACTS

Prior to Year 1, Company was in the business of manufacturing, processing and distributing building materials that allegedly contained asbestos. As a result of Company's activities involving asbestos-related products tens of thousands of asbestos-related personal injury claims have been asserted against Company. Currently, there are in excess of X asbestos-related personal injury claims asserted against Company seeking damages for injuries allegedly caused by exposure to asbestos containing products manufactured or distributed during Company's former operations. Since Year 1, Company has been primarily processing and resolving asbestos-related and other liability claims arising from prior operations, including the realization of insurance proceeds and management of investments and cash flows to satisfy those claims.

On Date 1, Company filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. Company has continued in possession of its assets and continues to manage its affairs as a debtor in possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code. No trustee or examiner has been appointed. Company believes that the aggregate asbestos-related and other liabilities of Company are in excess of the value of Company's bankruptcy estate.

On or around Date 2, Company received cash and marketable securities with a market value of approximately Y from a pre-bankruptcy petition insurance settlement, which Company deposited in its name in a segregated investment account at A and managed by B. Company intends to use the insurance settlement proceeds and other sources of funds, to pay asbestos-related personal injury and related liability claims pursuant to a plan of reorganization after the plan is confirmed by the bankruptcy court. However, Company believes that the plan will not be confirmed prior to its fiscal year-end on Date 4; therefore, no distributions from the segregated investment account can be made to asbestos and related claimants until the court approves the plan of reorganization. In order to avoid unintended tax consequences as a result of the receipt of the insurance settlement proceeds on Date 2, Company filed a motion with the bankruptcy court to establish a qualified settlement fund under section 1.468B-1(c) to resolve or satisfy the asbestos-related personal injury and related liability claims. After entry of an order establishing a qualified settlement fund, Company would transfer assets, including some or all of the insurance settlement proceeds to the qualified settlement fund to resolve or satisfy those claims.

On Date 3, the bankruptcy court entered an order establishing Fund as a separate segregated investment account at A with the intent that the same meet the requirements of a qualified settlement fund under section 1.468B-1(c). Pursuant to the court's order, Fund must be maintained in a separate segregated account and Company may transfer the insurance settlement proceeds referred to above into Fund, as well as future insurance proceeds and other amounts. Unless otherwise ordered by

the bankruptcy court, the amounts transferred to Fund will only be used to resolve or satisfy “qualified claims,” defined in Company’s motion as “claims described in Treasury Regulation § 1.468B-1(c)(2)” and the administrative expenses of operating Fund. Company shall have no independently exercisable right to a refund or reversion of any portion of Fund, and no such refund or reversion shall occur without further order of the bankruptcy court. The order also appoints co-administrators of Fund who will be charged with investing Fund’s assets in accordance with guidelines established by the bankruptcy court and applicable court rules, paying the reasonable operating expenses of Fund, maintaining Fund’s financial records separate and apart from Company, as well as obtaining the federal tax identification number and timely filing and paying any and all federal, state and local taxes as may be required under the appropriate laws. Finally, the bankruptcy court shall retain jurisdiction over Fund until such time as all of the assets of Fund have been disbursed in accordance with the order, and the overall plan of reorganization.

Finally, Company represents that as of the date of its July 21, 2005 correspondence it had not yet begun transferring assets to Fund, but intends to start making transfers on or before its fiscal year ends on Date 4.

LAW AND ANALYSIS

1. Classification of Fund as a Qualified Settlement Fund

Section 468B(g) of the Code provides, in part, that nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. Pursuant to the authority of section 468B(g), the Secretary has published sections 1.468B-1 through 1.468B-5 of the regulations regarding qualified settlement funds.

Section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies all three requirements of section 1.468B-1(c). First, section 1.468B-1(c)(1) requires that the fund, account, or trust is established pursuant to an order of, or it 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 continued jurisdiction of that governmental authority. Second, section 1.468B-1(c)(2) requires that the fund, account, or trust 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; (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. Third, section 1.468B-1(c)(3) provides that the fund, account, or trust must be a trust under applicable state law, or its assets must be otherwise segregated from other assets of the transferor (and related persons).

Section 1.468B-1(j)(1) provides that if a fund, account or trust is established to resolve or satisfy claims described in section 1.468B-1(c)(2), the assets of the fund, account, or trust are treated as owned by the transferor of those assets until the fund, account, or trust also meets the requirements of sections 1.468B-1(c)(1) and (c)(3). On the date the fund, account, or trust satisfies all the requirements of section 1.468B-1(c), the transferor is treated as transferring the assets to a qualified settlement fund.

Section 1.468B-2(k)(2) provides that a qualified settlement fund is in existence for the period that (i) begins on the first date on which the fund is treated as a qualified settlement fund under section 1.468B-1; and (ii) ends on the earlier of the date the fund (A) no longer satisfies the requirements of section 1.468B-1; or (B) no longer has any assets and will not receive any more transfers.

Based on the facts represented, once Company transfers assets to Fund the three requirements of section 1.468B-1(c) will be satisfied and Fund will be treated as a qualified settlement fund for federal income tax purposes. First, Fund is established pursuant to an order of the bankruptcy court dated Date 3 over which the court retains jurisdiction during Fund's complete administration. See § 1.468B-1(c)(1). Second, Fund is established to resolve or satisfy asbestos-related personal injury and related liability claims brought against Company for damages for injuries allegedly caused by exposure to asbestos containing products manufactured or distributed by Company. See § 1.468B-1(c)(2). Third, Fund will be maintained in a separate segregated investment account at A and kept segregated from the other assets of Company. See § 1.468B-1(c)(3).

2. Deductibility of Amounts Transferred to Fund

Section 162(a) of the Code provides the general rule 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. See also § 1.162-1(a). Payments made in settlement of a lawsuit or potential lawsuits are generally deductible under section 162(a) if the acts that gave rise to the litigation were performed in the ordinary conduct of the taxpayer's business. See Rev. Rul. 80-211, 1980-2 C.B. 57, and the authorities cited therein.

Section 461(a) provides, in part, that the amount of any deduction shall be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2) provides, in part, that under an accrual method of accounting, a liability is incurred, and generally taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h)(1) provides, in part, 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)(4) provides that the all events test is met with respect to any item if all events have occurred which determine the fact of the liability and the amount of such liability can be determined with reasonable accuracy.

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)(2) provides that economic performance does not occur to the extent (A) the transferor (or a related person) has a right to a refund or reversion of a transfer if that right is exercisable currently and without the agreement of an unrelated person that is independent or has an adverse interest (e.g., the court or agency that approved the fund, or the fund claimants), or (B) money or property is transferred under conditions that allow its refund or reversion by reason of the occurrence of an event that is certain to occur, such as the passage of time, or if restrictions on its refund or reversion are illusory.

Section 1.468B-3(d) provides that no deduction is allowed to a transferor 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 gross income.

Based on the foregoing, and to the extent the all events test is otherwise met, Company may deduct the amount of cash and the fair market value of other property transferred to Fund in the year of transfer, except to the extent the amounts transferred to Fund by Company represent amounts received from the settlement of an insurance claim and are excludable from Company's gross income.

CONCLUSIONS

Based solely on the information provided and the representations made, we conclude as follows:

(1) Fund, once effective, will be a qualified settlement fund under section 1.468B-1(c) of the Income Tax Regulations; and

(2) to the extent that the requirements of sections 162 and 461(h) of the Code are otherwise met, Company may deduct the amount of cash and the fair market value

of other property transferred to Fund in the year of transfer, except to the extent the amounts transferred to Fund by Company represent amounts received from the settlement of an insurance claim and are excludable from Company's gross income.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. This ruling is directed only to Company. Further, section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Finally, the rulings contained in this letter are based upon information and representations submitted by Company and accompanied by a penalty of perjury statement executed by an appropriate party. 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.

Sincerely,

Jeffery G. Mitchell
Chief, Branch 6
(Income Tax & Accounting)