

200719017

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



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

FEB 12 2007

Uniform Issue List: 408.03-00

T: EP: RA: T3

Legend:

- Individual A =
- Individual B =
- State C =
- Company M =
- Company N =
- Company O =
- Company P =
- Company Q =
- Association R =
- IRA W =
- IRA X =
- IRA Y =
- IRA Z =

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Account A =

Account B =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Amount 5 =

Amount 6 =

Amount 7 =

Amount 8 =

Amount 9 =

Amount 10 =

Amount 11 =

Amount 12 =

Amount 13 =

Amount 14 =

Amount 15 =

Amount 16 =

Amount 17 =

Amount 18 =

Amount 19 =

Amount 20 =

Amount 21 =

Amount 22 =

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- Individual C =
- Individual D =
- Attorney E =
- Attorney F =
- Law Firm G =
- IRA U =

- IRA V =

- Loss A =
- Loss B =
- Loss C =
- Loss D =
- Allocation Y =
- Allocation Z =
- Allocation B =

Dear , :

This is in response to correspondence dated December 27, 2004, as supplemented by correspondence dated June 22, August 12, and December 7, 2005, and December 14, 2006, submitted on your behalf by your authorized representative, and a discussion with your authorized representative on January 9, 2007, concerning the status of contributions to your Individual Retirement Arrangements (IRAs).

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested:

Individual A is married to Individual B. Individuals A and B are residents of State C. Individuals A and B file a joint Federal Form 1040.

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Individual A was employed by Company M from _____ Company M sponsored one or more retirement plans represented to be qualified within the meaning of section 401(a) of the Internal Revenue Code (Code) in which Individual A participated.

Individual A was employed by Company N from _____ Company N sponsored one or more retirement plans represented to be qualified within the meaning of section 401(a) of the Code in which Individual A participated.

Individual B was employed by Company O from _____ Company O sponsored one or more retirement plans represented to meet the requirements of section 403(b) of the Code in which Individual B participated.

Individual A was eligible to receive a distribution from his Company M qualified plan due to his termination on _____ On _____ a direct transfer of Amount 1, Individual A's accrued benefits in his Company M plan, was made into IRA W. IRA W was an IRA Individual A established with Company Q on _____ and it contained assets prior to this direct transfer. IRA W was an IRA described in section 408(a) of the Code.

In _____ Individual A established IRA Y with Company P. IRA Y was an IRA described in section 408(a) of the Code. On _____ a direct transfer of _____ was made from IRA W to IRA Y. On _____ was deposited into IRA Y as a direct transfer from IRA W. These transferred amounts were the total account balance of IRA W.

Individual A was also eligible to receive a distribution from his Company N qualified plan due to his termination on _____ On _____ a direct transfer of _____ Individual A's accrued benefits in his Company N plan, was made into IRA Y.

Individual B was eligible to receive a distribution from her Company O section 403(b) plan due to her termination in _____ On _____ Company O issued a check for _____ payable to IRA Z, an IRA Individual B established with Company P. IRA Z was an IRA described in section 408(a) of the Code. This direct rollover of _____ was deposited into IRA Z on _____

Individual B also maintained IRA X with Company Q. IRA X was an IRA described in section 408(a) of the Code. Pursuant to a direct transfer, Individual B terminated IRA X in _____ and her account balance in IRA X was deposited into IRA Z on _____ The amount of the assets received by IRA Z was _____

Individuals A and B also maintained Account A, a personal investment account with Company Q. In _____ Individuals A and B withdrew _____ from Account A and deposited it into Account B, a personal investment account established with Company P. _____ was used to purchase stock as an Account B investment. Account B consisted of the following stock transactions: on _____ stock valued at _____ was received; on _____ stock costing _____ was purchased; and during _____ through _____ stock costing _____ was purchased. _____ plus _____ totaled _____

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During through Individuals A and B withdrew amounts from Account B, eventually resulting in the closure of Account B. On was withdrawn; on was withdrawn; and on was withdrawn, resulting in the closure of Account B.

Individual C, employed as a Retirement Planning Specialist with Company P, managed IRA Y and IRA Z from until about By the values of IRA Y, IRA Z and Account B held with Company P had decreased significantly. In or about Individuals A and B were informed by Company P that they had been assigned a new financial advisor, Individual D. During the period that Individual D acted as the financial advisor to Individuals A and B, the value of IRA Y, IRA Z and Account B continued to decrease.

Company P is a member of Association R. On Individuals A and B instituted an Association R Arbitration proceeding against Company P (Matter in Arbitration).

The Matter in Arbitration alleged that Individuals C and D were employed as financial advisors by Company P.

The Matter in Arbitration contained factual allegations to the effect that Company P, through Individuals C and D, advised Individuals A and B to invest their funds, including their IRAs, contrary to their stated investment objectives and risk tolerance. The Matter in Arbitration also alleged that Company P, through Individuals C and D, although aware that Individuals A's and B's "investment objective was to save for retirement without losing their savings" failed to invest their funds accordingly, but instead invested "in highly volatile technology and internet stocks". The Matter in Arbitration stated that Individuals A and B lost in excess of in unsuitable investments recommended by financial advisors employed by Company P.

Based on the above allegations and other allegations contained in the Matter in Arbitration, Individuals A and B alleged that the actions of Company P constituted: (1) breach of fiduciary duty; (2) common law fraud; (3) constructive fraud; (4) negligent misrepresentation; (5) breach of contract, breach of duty, and negligence; and (6) violations of the State C Securities Act. Furthermore, the actions of Company P were the proximate causes of the losses suffered by Individuals A and B with respect to the investments in IRA Y, IRA Z, and Account B.

Individuals A and B were represented by Attorney E and Attorney F, licensed to practice law in State C.

On Individuals A and B entered into a settlement agreement with Company P ("Settlement Agreement"). In the Settlement Agreement, Company P agreed to pay Individuals A and B in exchange for dismissing, with prejudice, their claim against Company P.

From documentation contained in the file, it appears that the above-referenced settlement was the result of "arm's-length negotiations" between various parties with adverse interests and your authorized representative has asserted, on your behalf, that they were.

Pursuant to the Settlement Agreement, the Matter in Arbitration against Company P was dismissed.

Pursuant to the provisions of the Settlement Agreement reached between Individual A, Individual B, and Company P, on or about [redacted] a check in the amount of [redacted] payable to Individuals A and B, was sent by Company P to Law Firm G, the law firm with which Attorneys E and F were associated. The check was deposited into a Law Firm G trust account. The sum of the settlement proceeds paid by Company P less attorneys' fees and expenses associated with the Matter in Arbitration totaled [redacted]. No part of [redacted] has been distributed; it is still intact in the Law Firm G trust account.

The Settlement Agreement does not specify the portion of [redacted] that represented Individual A's IRA Y losses, Individual B's IRA Z losses, or Individuals A's and B's Account B losses.

Contributions to IRA Y consisted of [redacted] which totaled [redacted]. On or about [redacted] IRA Y was closed out and the account balance of [redacted] was deposited into IRA U, an IRA established in the name of Individual A. The amount of the loss which IRA Y experienced during its existence was Loss A.

Contributions to IRA Z consisted of [redacted] which totaled [redacted]. On or about [redacted] IRA Z was closed out and the account balance of [redacted] was deposited into IRA V, an IRA established in the name of Individual B. The amount of the loss which IRA Z experienced during its existence was Loss B.

Deposits to Account B consisted of [redacted] which totaled [redacted]. Withdrawals of [redacted] and [redacted] reduced the initial deposits to [redacted]. On [redacted] [redacted] was withdrawn, resulting in the closure of Account B. The amount of the loss which Account B experienced during its existence was Loss C.

It is the intent of Individual A to deposit the portion of the proceeds of the Settlement Agreement representing losses in IRA Y into IRA U. It is the intent of Individual B to deposit the portion of the proceeds of the Settlement Agreement representing losses in IRA Z into IRA V.

It has been represented that neither Individual A nor Individual B received a Form 1099 with respect to amounts received as a result of the above-referenced Matter in Arbitration and Settlement Agreement.

Based on these facts and representations, you request the following letter rulings:

1. That for purposes of determining how much of Amount 17, the net settlement proceeds payable to Individual A and Individual B, should be treated as representing IRA losses incurred by Individual A and Individual B, said [redacted],

should be allocated between Individual A's and B's IRAs and non-IRA account in proportion to the losses incurred in each account; and

2. The amounts representing IRA losses, as determined in response to your first ruling request, may be contributed as replacement payments to the IRAs of Individuals A and B.

With respect to the requested letter rulings, Code sections 219 and 408 govern the timing and amount of contributions to Individual Retirement Arrangements (see e.g. Code sections 219(b)(1), 219(b)(5), 219(f)(3) and 408(d)(4)). The initial issue presented in this case is whether the Service should treat _____ as replacing losses suffered by Individuals A's and B's IRAs Y and Z respectively and, as a result, not treat the intended contributions of portions of _____ to IRAs U and V as ordinary contributions subject to the limitations of Code sections 219 and 408.

With respect to the initial issue, it has been represented that Individuals A and B initiated an arbitration action against Company P relating to significant losses in value of various investments, including an IRA set up and maintained in the name of Individual A and an IRA set up and maintained in the name of Individual B. The arbitration action alleged various causes of said losses of value relating to activities taken either by Company P or other named parties allegedly acting as the agents of Company P. All parties to the arbitration action were represented by counsel, and the arbitration action was settled "in good faith". Pursuant to the settlement, Individuals A and B recovered, after attorney's fees were deducted, Amount 17 which represented losses suffered in both Individuals A's and B's IRAs, and non-IRA property held jointly by Individuals A and B. _____ is being held by Law Firm G pending the issuance of this letter ruling.

A determination of whether settlement proceeds should be treated as a replacement payment, rather than an ordinary contribution, must be based on all the relevant facts and circumstances surrounding the payment of the settlement proceeds (see Revenue Ruling 2002-45, 2002-2 C.B.116, which applies a facts and circumstances test to determine whether a payment to a qualified plan under Code section 401(a) is a restorative payment to a plan as opposed to a plan contribution). We believe that it is appropriate to apply the reasoning of Rev. Rul. 2002-45 to IRAs.

As a general rule, payments to an IRA are restorative payments only if the payments are made in order to restore some or all of the IRA losses resulting from breach of fiduciary duty, fraud or federal or state securities violations (such as payments made pursuant to a court-approved settlement or independent third-party arbitration or mediation award). In contrast, payments made to an IRA to make up for losses due to market fluctuations or poor investment returns are generally treated as contributions and not as restorative payments.

In the instant case, as noted above, Individuals A and B instituted an Association R Arbitration proceeding against Company P. The Matter in Arbitration contained factual allegations to the effect that Company P, through Individuals C and D, advised Individuals A and B to invest their funds, including their IRAs, contrary to their stated investment objectives and risk tolerance. The Matter in Arbitration stated that Individuals A and B lost in excess of _____ in unsuitable investments recommended by financial advisors employed by Company P and the actions of Company P were the

proximate causes of the losses suffered by Individuals A and B with respect to the investments in IRA Y, IRA Z, and Account B. Subsequently, Individuals A and B and Company P settled the Matter in Arbitration. Furthermore, all of the parties to the Matter in Arbitration were represented by counsel.

Accordingly, from the facts presented in this case, the payment from Company P to Individuals A and B was the result of an arm's-length settlement of a good faith claim of liability, and, as such, if portions of _____ are contributed to the IRAs as is the intent of Individuals A and B said contributions will be restorative payments, rather than additional contributions, to their IRAs made to merely replenish their IRA account balances after investment losses.

In this case, the Service has noted that IRA Y experienced a loss of Loss A, IRA Z experienced a loss of Loss B, and Account B experienced a loss of Loss C. Loss A and Loss B and Loss C total Loss D. Loss A is approximately _____ of Loss D; Loss B is approximately _____ of Loss D; and Loss C is approximately _____ of Loss D.

The above-referenced settlement proceeds were designed to replace a portion of Individual A's and Individual B's losses (IRA and non-IRA) due to alleged misconduct on the part of Company P.

In this case, as indicated above, the Service notes that the Settlement Agreement did not specify which portions of _____ were allocable to Individual A's IRA losses, Individual B's IRA losses, or Individuals A's and B's non-IRA losses. In the absence of such specification, the Service concludes that it is appropriate to allocate a pro-rata portion of _____ attorney's fees and expenses) to such IRA and non-IRA losses.

Since Loss A is approximately _____ of Loss D, _____ of _____ is Allocation Y. Since Loss B is approximately 44.7 percent of Loss D, _____ of _____ is Allocation Z. Since Loss C is approximately _____ of Loss D, _____ of _____ is Allocation B.

Thus, with respect to your first ruling request, we conclude that for purposes of determining how much of _____ the net settlement proceeds payable to Individual A and Individual B, should be treated as representing IRA losses incurred by Individual A and Individual B, said _____ should be allocated between Individual A's and B's IRAs and non-IRA account in proportion to the losses incurred in each account. As a result of the proportional allocation, Allocation Y represents a recovery of some of the losses suffered in Individual A's IRA Y, and Allocation Z represents a recovery of some of the losses suffered in Individual B's IRA Z.

With specific respect to your second ruling request, as noted above, Allocations Y and Z represent recoveries of IRA losses. Furthermore, as detailed above, said Allocations were recovered as a result of an arm's-length transaction between adverse parties which was settled in good faith. Thus, the Service will treat Allocations Y and Z as restorative payments.

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Accordingly, with respect to your second ruling request, based on the particular facts and circumstances presented herein, we hold that, if contributed to IRAs U and V, respectively, Allocation Y and Allocation Z will be considered to be restorative payments replacing portions of Individual A's and B's losses in IRAs Y and Z, and, as such, will not be subject to the limitations on contributions found in Code sections 219 and 408.

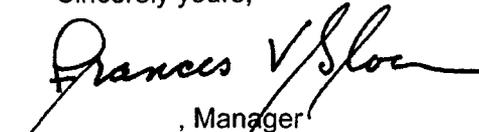
No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This letter expresses no opinion as to whether the IRAs described herein satisfied the requirements of section 408 of the Code and assumes that they do in accordance with representations made to that effect.

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

Pursuant to a power of attorney on file with this office, a copy of this ruling letter is being sent to your authorized representative. If you wish to inquire about this ruling, please contact _____, I.D. # _____, at _____. Please address all correspondence to _____.

Sincerely yours,


_____, Manager
Employee Plans Technical Group

Enclosures:

Deleted copy of letter ruling
Notice of Intention to Disclose