

200724040



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 408.03-00

MAR 20 2007

T:EP:RA:T2

Legend:

Taxpayer A =

IRA X =

Company C =

Amount B =

Amount D =

Amount K =

Company E =

Account F =

Account G =

Company H =

Amount R =

Company J =

Dear

This is in response to your letter dated November 23, 2005, as supplemented by correspondence dated February 2, 2007, submitted by your authorized representative, concerning the status of a contribution to your individual retirement account (IRA).

The following facts and representations have been submitted under penalties of perjury in support of your request.

Taxpayer A, established an individual retirement arrangement, IRA X, with Company C in January 2000. It is represented that the investment advisor for Company C made multiple unauthorized transactions in Taxpayer A's IRA, such as changing the investments from conservative blue chip stocks and bonds to speculative tech stocks. It is further represented that the tech stock values crashed shortly thereafter and Taxpayer A lost over sixty percent of the original value of her IRA. In May 2003, Company J's arbitration panel awarded Taxpayer A, Amount B, which consisted of compensatory damages, attorney's fees, and expert witness fees. It is further represented that after payment of attorney's fees, and expenses, Taxpayer A's net award was Amount K.

Documentation submitted by Taxpayer A shows that Amount D, was deposited into Account F at Company E on July 14, 2003. Documentation submitted by Taxpayer A shows that a portion of that amount, Amount R, was subsequently transferred to Account G at Company H on July 28, 2004.

Based upon the foregoing, you request the following ruling:

1. That Amount D received by Taxpayer A pursuant to Company J's arbitration settlement may be contributed as a replacement payment to IRA X

.With respect to the requested ruling, Code sections 219 and 408 govern the timing and amount of contributions to Individual Retirement Arrangements (see e.g., Code section 219(b)(1), 219(b)(5), 219(f)(3) and 408(d)(4)). The initial issue in this case is whether the Service should treat Amount D as replacing losses suffered by Taxpayer A and, as a result, not treat the intended contribution of Amount D to IRA X as ordinary contribution subject to the limitations of Code sections 219 and 408.

With respect to the initial issue, it has been represented that Taxpayer A initiated an arbitration action against Company C relating to significant losses in value of various assets of IRA X set up and maintained in the name of Taxpayer A. The arbitration action was settled "in good faith". Pursuant to the settlement, Taxpayer A recovered, after attorney's fees and other expenses were deducted, Amount D which represented losses suffered by Taxpayer A's IRA.

A determination of whether settlement proceeds should be treated as 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, payment 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, Taxpayer A instituted a Company J Arbitration proceeding against Company C. The Matter in Arbitration contained factual allegations to the effect that Company C made multiple unauthorized transactions in Taxpayer A's IRA, such as changing the investments from conservative blue chip stocks and bonds to speculative tech stocks. Actions of Company C were proximate cause of the loss suffered by Taxpayer A with respect to her IRA X assets. Arbitration action was settled in "good faith".

Accordingly, from the facts presented in this case, the payment from Company C to Taxpayer A was the result of an arm's length settlement of a good faith claim of liability, and, as such, if Amount D is contributed to IRA X as is the intent of Taxpayer A said contribution will be restorative payments, rather than additional contributions, to her IRA X.

Thus, with respect to your ruling request, we conclude that the settlement proceeds received by Taxpayer A should be treated as a replacement payment to IRA X.

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

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

A copy of this letter is being sent to your authorized representative in accordance with a Power of Attorney (Form 2848) on file in this office.

If you have any questions regarding this letter, please contact:
(SE:T:EP:RA:T:2 at

Sincerely yours,



Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures:

Deleted copy of letter ruling
Notice 437

cc: