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Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:ITA:B07
PLR-108145-07

Date:
July 17, 2007

Legend

<u>X</u>	=	
Trust	=	
Bankruptcy Court	=	
Court	=	
State P	=	
Date a	=	
Date b	=	
Date c	=	
Date d	=	
Date e	=	
Date f	=	
Date g	=	
Date h	=	
y	=	

Dear _____ :

This responds to your letter requesting certain rulings concerning the application of § 468B of the Internal Revenue Code to X and the Trust. In particular, you requested the following rulings:

1. The Trust is a qualified settlement fund under § 1.468B-1 of the Income Tax Regulations.
2. The Trust's modified gross income does not include amounts transferred by X to the Trust, except to the extent of any dividends paid to the Trust on X stock.
3. The Trust's initial basis in assets (other than cash) transferred by X to the Trust is the fair market value of any such asset on the date of transfer.
4. To the extent the requirements of §§ 162 and 461(h) are otherwise met, X may deduct the amount of cash transferred and the fair market value of other assets (other than the Fund, as defined below) that X transfers to the Trust in the taxable year or years of the transfers, except that no deduction is allowable for the transfer of the X stock unless the qualified appraisal requirements of § 1.468B-3(b) are satisfied and no deduction is allowable for transferred amounts that represent amounts received from the settlement of an insurance claim which is excludable from X's gross income.
5. X may exclude any discharge of indebtedness income realized because of the discharge, release, and extinguishment of all its obligations for or in respect of its liability for Personal Injury Claims.
6. The portion of any net operating loss attributable to deductions for Personal Injury Claims, including deductions allowable as a result of transfers to the Trust, is a specified liability loss as defined in § 172(f)(1)(A).

FACTS

X and its predecessors is a corporation that was engaged in the distribution and installation of insulation materials, some of which contained asbestos-related materials, until Date a. In Date a, because of the high cost of liability insurance, or its complete unavailability, X ceased the distribution and installation of insulation materials and ceased conducting business as an insulator contractor. Since Date a, X has directed its efforts to processing and resolving claims filed by individuals for alleged losses associated with bodily injuries and sickness allegedly arising from exposure to asbestos. X uses an accrual method of accounting for federal income tax purposes.

On Date b, X filed a petition in Bankruptcy Court for relief under Chapter 11 of Title 11 of the United States Code. In Date c, X reached a financial settlement with an insurer with regard to X's claims for insurance for asbestos-related liabilities. X filed a motion with the Bankruptcy Court to establish a separate, segregated account to which

it could transfer a portion of the proceeds it received from the insurance settlement to be used to satisfy claims for asbestos-related liabilities. On Date d, the Bankruptcy Court entered an order directing X to establish a segregated account (the "Fund") and to deposit a portion of the insurance settlement proceeds in the Fund to be used, except as directed by the Bankruptcy Court, to resolve or satisfy X's asbestos-related claims. X represents that the Fund is a qualified settlement fund within the meaning of § 1.468B-1.

On Date e, the Bankruptcy Court confirmed X's Chapter 11 plan of reorganization (the "Plan"). On Date f, Court affirmed the Bankruptcy Court's confirmation order. The Plan provides for the creation and funding of the Trust.

On Date g, the Trust was formed and the Plan became effective. The Trust Agreement provides that the purpose of the Trust is to assume all of X's liabilities for asbestos-related injury claims and to use its assets, contributed by X now and in the future, to pay holders of asbestos-related claims against X. The Trust and X represent that a portion of the assets and cash that X will transfer to the Trust will be used to make payments directly to claimants for "Personal Injury Claims." The Trust and X also represent that each payment for Personal Injury Claims meets the following requirements:

- (i) It is a payment of compensatory damages on account of physical injury or emotional harm to an individual that manifests itself before the date the Trust makes that payment (or interest on such payment); and
- (ii) The payment is being made to satisfy X's liability for damage arising from X's sale of asbestos-containing products (including installation, removal and/or manipulation of asbestos that taxpayer sold), which damage arose after X relinquished possession of the asbestos-containing products.

According to the Plan, the Trust assumed all of X's liabilities for Personal Injury Claims, including pre-petition liquidated Personal Injury Claims. As of Date g, X was discharged from, and has no further responsibility or liability for, any Personal Injury Claims. Consequently, all current and future Personal Injury Claims are to be resolved pursuant to the terms of Plan, Trust Agreement, and Trust Distribution Procedures. The Trust was established as a trust under the law of State P and is administered by a trustee appointed by the Plan. The Bankruptcy Court order dated Date e provides that the Bankruptcy Court retains jurisdiction over any matter arising under or related to the Plan. No refund or reversion of the Trust's assets to X can occur other than by order of the Bankruptcy Court.

The Plan provides that X shall issue X common stock to the Trust which, after issuance, shall constitute one hundred percent of X's issued and outstanding shares of capital stock. On Date h, X issued y shares of common stock to the Trust, and the

previous equity interests of X were canceled for no distribution, forgiveness of debt, or any other consideration in connection with confirmation of the Plan. The Plan also provides that upon the Trust's request, with the consent of X, such consent not to be unreasonably withheld, X shall remit to the Trust the Fund and various other assets.

In addition to payment of Personal Injury Claims, the Trust is responsible for payments of costs, taxes, and expenses of or imposed on, assumed by or in respect of the Trust attributable or allocable to Personal Injury Claims, including, but not limited to, trustee compensation, employee compensation, insurance premiums, legal, accounting and other professional fees, and overhead.

LAW AND ANALYSIS

Status as Qualified Settlement Fund

The first requested ruling is that the Trust is a qualified settlement fund under § 1.468B-1 for federal income tax purposes. Section 468B(g)(1) 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. Sections 1.468B-1 through 1.468B-5 of the regulations provide guidance 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 § 1.468B-1(c). First, § 1.468B-1(c)(1) requires that the fund, account, or trust 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 continued jurisdiction of that governmental authority. Second, § 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, § 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(h)(2) provides that if a fund, account, or trust is established to resolve or satisfy claims described in § 1.468B-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.

Based on the facts presented and representations made, the three requirements of § 1.468B-1(c) are satisfied and, as such, the Trust is a qualified settlement fund for federal income tax purposes. First, the Trust has been approved pursuant to an order of the Bankruptcy Court dated Date e, over which the Bankruptcy Court retains jurisdiction during the Trust's complete administration. See § 1.468B-1(c)(1). Second, the Trust was established to resolve or satisfy claims brought against X for damages allegedly sustained as a result of exposure to asbestos. See § 1.468B-1(c)(2). Third, it is represented that the Trust is a trust under the law of State P. See § 1.468B-1(c)(3). Finally, the fact that claims other than claims described in § 1.468B-1(c)(2) may be paid by the Trust does not prevent the Trust from being treated as a qualified settlement fund. See § 1.468B-1(h)(2).

Modified Gross Income

The second requested ruling is that the Trust's modified gross income does not include amounts transferred to the Trust by or on behalf of X, except to the extent of any dividends paid to the Trust on X Stock. Section 1.468B-2(b) provides that the modified gross income of a qualified settlement fund is its gross income, as defined in § 61, computed with certain modifications. Under § 1.468B-2(b)(1), 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 the modified gross income of the fund. However, dividends on stock of a transferor (or a related person) are not excluded from modified gross income.

Amounts transferred to the Trust by or on behalf of X are transferred to resolve or satisfy the liabilities for which the Trust is established (i.e., X's asbestos-related liabilities). However, dividends on X stock transferred to the Trust by X are not excluded from the Trust's gross income. Section 1.468B-2(b)(1). Accordingly, based on the facts presented and representations made, the Trust's modified gross income does not include amounts transferred by or on behalf of X to the Trust to resolve or satisfy liabilities for which the Trust was established, except to the extent of any dividends paid to the Trust on X stock (or stock of a person related to X).

The Trust's Basis in Transferred Assets

The third requested ruling is that the Trust's initial basis in assets (other than cash) transferred by X to the Trust is the fair market value of any such asset on the date of transfer. Section 1.468B-2(e) provides that a qualified settlement fund's initial basis in property it receives from a transferor (or from an insurer or other person on behalf of a transferor) is the fair market value of that property on the date of transfer to the fund.

Section 1.468B-3(f)(1) provides that a transferor must include in gross income any distribution (including a deemed distribution described in § 1.468B-3(f)(2)) it receives from a qualified settlement fund. If property is distributed, the amount

includible in gross income and the basis in that property, is the fair market value of the property on the date of the distribution. Section 1.468B-3(f)(2) provides that, if a qualified settlement fund makes a distribution on behalf of a transferor to a person that is not a claimant, or to a claimant to resolve or satisfy a liability of the transferor (or a related person) other than a liability described in § 1.468B-1(c)(2) for which the fund was established, the distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to have made a payment to the actual recipient.

Based on the facts presented and representations made, the Trust's initial basis in assets (other than cash) transferred by X to the Trust, including any assets deemed transferred by X to the Trust pursuant to § 1.468B-3(f)(2), is the fair market value of any such asset on the date of transfer.

X's Deductions for Transfers to the Trust

The fourth requested ruling is that to the extent the requirements of §§ 162 and 461(h) are otherwise met, X may deduct the amount of cash transferred and the fair market value of other assets (other than the Fund) that X transfers to the Trust in the taxable year or years of the transfers, except that no deduction is allowable for the transfer of the X stock unless the qualified appraisal requirements of § 1.468B-3(b) are satisfied and no deduction is allowable for transferred amounts that represent amounts received from the settlement of an insurance claim which is excludable from X's gross income.

Section 162(a) allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Payments made in settlement of a lawsuit or potential lawsuits are generally deductible under § 162 if the acts that gave rise to the litigation were performed in the ordinary course of the taxpayer's business. See *United States v. Gilmore*, 372 U.S. 39 (1963); Rev. Rul. 80-211, 1980-2 C.B. 57. Even though a particular taxpayer may incur an expense only once in the lifetime of its business, the expense may qualify as ordinary and necessary if it is appropriate and helpful in carrying on that business, is commonly and frequently incurred in the type of business conducted by the taxpayer, and is not a capital expenditure. *Commissioner v. Tellier*, 383 U.S. 687 (1966); *Deputy v. du Pont*, 308 U.S. 488 (1940).

Section 461(a) provides that a 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 that, under an accrual method of accounting, a liability is incurred, and generally is 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 that in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to the item occurs.

Section 1.468B-1(d)(1) provides that a “transferor” is a person that transfers (or on behalf of whom an insurer or other person transfers) money or property to a qualified settlement fund to resolve or satisfy claims described in § 1.468B-1(c)(2) against that person.

Section 1.468B-3(a)(1) provides that a transferor must treat a transfer of property to a qualified settlement fund as a sale or exchange of that property for purposes of § 1001. In computing the gain or loss, the amount realized by the transferor is the fair market value of the property on the date the transfer is made to the qualified settlement fund. Because the issuance of a transferor’s debt, obligation to provide services or property in the future, or obligation to make a payment described in § 1.461-4(g), is generally not a transfer of property by the transferor, it generally does not result in gain or loss to the transferor under this paragraph (a)(1).

Section 1.468B-3(c)(1) provides that, except as otherwise provided in that section, for purposes of § 461(h), economic performance occurs with respect to a liability described in § 1.468B-1(c)(2) (determined with regard to § 1.468B-1(f) and (g)) to the extent the transferor makes a transfer to a qualified settlement fund to resolve or satisfy the liability. However, § 1.468B-3(c)(2)(i)(A) and (B) provide that economic performance does not occur to the extent 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 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. In addition, § 1.468B-1(h)(2) provides that economic performance does not occur with respect to transfers to a qualified settlement fund for non-allowable claims.

Section 1.468B-3(b)(1) provides that a transferor must obtain a qualified appraisal to support a loss or deduction it claims with respect to a transfer to a qualified settlement fund of nonpublicly traded securities (as defined in § 1.170A-13(c)(7)(ix)) issued by the transferor (or a related person).

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 gross income.

Under § 1.468B-3(c)(1), economic performance occurs in the taxable year or years in which X transfers property to the Trust within the meaning of § 1.468B-3(a)(1) to the extent that the transfers are allocable to liabilities described in § 1.468B-1(c)(2). To the extent X makes a transfer of property to the Trust, X's liability is fixed and determinable with reasonable accuracy no later than the time when X makes such transfer of property to the Trust. Finally, X's liability arose from the conduct of its business and, therefore, represents an expense deductible under § 162. Accordingly, based on the facts presented and representations made and provided that the qualified appraisal requirements of § 1.468B-3(b) are satisfied, X may deduct under § 162 the amount of cash transferred and the fair market value of other assets (other than the Fund¹) that X transfers to the Trust in the taxable year or years of the transfers, but only to the extent that (i) the transfers are allocable to liabilities described in § 1.468B-1(c)(2) and (ii) the transferred amounts do not represent amounts received from the settlement of an insurance claim which is excludable from X's gross income.

Cancellation of Indebtedness

Section 61(a)(12) provides that gross income includes income from the discharge of indebtedness. Such income (also known as cancellation of indebtedness income, or COD income) is ordinary in nature and equals the difference between what is owed and what is actually paid to satisfy the liability. COD income must generally be reported by the debtor in the year the discharge occurs.

Section 108(a)(1)(A) excludes from gross income any amount that would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if the discharge occurs in a title 11 (bankruptcy) case. Section 108(b)(1) generally requires taxpayers to reduce their attributes by the amount excluded from gross income under § 108(a)(1)(A).

To the extent the pre-petition liquidated Personal Injury Claims were discharged under the Plan for amounts that were less than their face value, X presumptively has discharge of indebtedness income under § 61(a)(12). *Preslar v. Commissioner*, 167 F.3d 1323 (10th Cir. 1999). However, because X was discharged from all current and future obligations and liabilities relating to the pre-petition liquidated Personal Injury Claims pursuant to the Plan, the § 108(a)(1)(A) exception applies. Accordingly, based on the facts presented and representations made, we conclude that (i) discharge of indebtedness income with respect to any of the pre-petition liquidated Personal Injury Claims that were discharged under the Plan is excluded from the X's gross income, and (ii) X must reduce its tax attributes under § 108(b)(1) with respect to the amount excluded from income under § 108(a)(1)(A).

¹ X does not request a ruling regarding whether it may deduct the fair market value of any of the Fund's assets it is deemed to transfer to the Trust under § 1.468B-3(f)(2). Accordingly, we express no opinion regarding X's ability to deduct the fair market value of any such assets, or X's treatment of a deemed distribution from the Fund under § 1.468B-3(f).

The settlement of unliquidated Personal Injury Claims, however, does not give rise to discharge of indebtedness income. Rather, if the dispute concerning the amount of the debt is in good faith, settlement of the dispute is “treated as the amount of debt cognizable for tax purposes.” *Preslar*, supra, at 1327, quoting *Zarin v. Commissioner*, 916 F.2d 110, 115 (3d Cir. 1990). Accordingly, we conclude that X did not realize discharge of indebtedness income from the release of any unliquidated Personal Injury Claims.

Specified Liability Losses

Section 172(a) allows as a deduction for the taxable year an amount equal to the aggregate of (1) net operating loss (NOL) carryovers to such year, plus (2) the NOL carrybacks to such year. Under § 172(b)(1)(C), the portion of an NOL that qualifies as a specified liability loss may be carried back to each of the 10 taxable years preceding the loss.

Section 172(f)(1)(A) defines a specified liability loss, in part, as the sum of the following amounts to the extent taken into account in computing the NOL for the taxable year: any amount allowable as a deduction under §§ 162 or 165 that is attributable to (i) product liability, or (ii) expenses incurred in the investigation or settlement of, or opposition to, claims against the taxpayer on account of product liability.

Section 172(f)(4) defines the term “product liability” as liability of the taxpayer for damages on account of physical injury or emotional harm to individuals, or damage to or loss of the use of property, on account of any defect in any product which is manufactured, leased, or sold by the taxpayer, but only if such injury, harm, or damage arise after the taxpayer has completed or terminated operations with respect to, and has relinquished possession of, such product.

Based on the facts presented and representations made, for those payments to the Trust that qualify as deductions under § 162, we conclude that X’s payments to the Trust are “specified liability losses” as defined in § 172(f) to the extent that the Trust uses such payments to make payments for Personal Injury Claims (except interest payments) to claimants. X may carryback these payments to each of the 10 taxable years preceding such loss. See § 172(b)(1)(C).

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 the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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.

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

Sincerely,

John P. Moriarty
Senior Technician Reviewer, Branch 7
(Income Tax & Accounting)