

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200924034**
Release Date: 6/12/2009

Third Party Communication: None
Date of Communication: Not Applicable

Index Number: 468B.00-00, 468B.04-01,
468B.07-00, 461.00-00,
162.00-00, 172.00-00,
172.01-00, 172.01-05,
172.06-00

Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B06
PLR-147011-08
Date: March 9, 2009

Attn:

Legend:

X =

Trust =

Date 1 =

P =

Bankruptcy Court =

Date 2 =

Plan =

q =

r =

s =

t =

Date 3 =

Asbestos Claims =

State E =

Effective Date =

Product =

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. As of the Effective Date of the establishment of the Trust, the Trust will be treated as a qualified settlement fund under Treas. Reg. § 1.468B-1.
2. The assets transferred by X to the Trust (other than interest payments on the Trust Note) will be excluded from the gross income of the Trust.
3. X may deduct its cash payments to the Trust, including principal payments pursuant to the Trust Note, in the year of payment in accordance with IRC §§ 162 and 461(h) and Treas. Reg. §§ 1.468B-3(c)(1) and -3(c)(3).
4. X's payments to the Trust (other than interest on the Trust Note), to the extent of any net operating loss for the taxable year, qualify as specified liability losses within meaning of IRC § 172(f)(1).

Facts

X is a wholly owned subsidiary of P, the parent of an affiliated group which files a consolidated federal income tax return. The affiliated group files its federal income tax

returns on a calendar year basis using the accrual method of accounting. A predecessor corporation of X produced and supplied Product, an asbestos-containing thermal insulation product, until Date 1. Since Date 1, X has become subject to liability for asbestos-related claims resulting from Product. Currently, there are approximately t asbestos-related claims asserted against X seeking damages for injuries allegedly caused by exposure to asbestos-containing products manufactured during the former operations of X's predecessor.

On Date 2, X filed a petition in Bankruptcy Court for relief under Chapter 11 of Title 11 of the United States Code. X and the asbestos claimants reached a settlement that included filing the Plan and executing a trust agreement to create the Trust for the benefit of the asbestos claimants. On the Effective Date of the Plan, X will transfer \$g in cash and a note (Trust Note) in the aggregate principal amount of \$r to the Trust. The terms of the Trust Note require X to make s payments of interest per year and scheduled pre-payments of principal, and the Trust Note matures in Date 3.

On the Effective Date of the Plan, the Asbestos Claims will be automatically assigned to, and indefeasibly vested in the Trust, and the Trust will become the estate representative, with the exclusive right to enforce any and all of the Asbestos Claims and causes of action against any entity. X's transfer of the assets to the Trust will be in complete settlement and satisfaction of its liabilities for the Asbestos Claims. The Trust will make payments only for asbestos-related personal injury claims (including related fees and expenses) and for the administration of the Trust. X represents that each payment for Asbestos Claims 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 and the payment is made to satisfy X's liability for damage arising from X's sale of asbestos-containing products (including production, installation, distribution, and/or removal of asbestos-containing products that X manufactured or sold), which damage arose after X relinquished the asbestos-containing products.

X represents that the Trust will be established as a trust under state law (it is expected to be under the law of State E), will be administered by individuals to be confirmed by the Bankruptcy Court, and that the Bankruptcy Court will retain jurisdiction over any matter arising under or related to the Plan. Neither X nor any related person to X will own any beneficial interest, directly or indirectly, in the corpus or income of the Trust. Additionally, the Trust will not be funded with amounts received by X from the settlement of insurance claims that are excludable from X's gross income. Furthermore, no portion of the amounts paid by X to the Trust represents payments for prejudgment and/or post-judgment interest. Also, X will not have refund or reversion rights in the Trust's assets or income.

Law and Analysis

1. Status as a Qualified Settlement Fund

X's 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. The statute further provides that the Secretary shall prescribe regulations providing for the taxation of any such account fund, whether as grantor trust or otherwise. 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 continuing 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) will be satisfied and, as such, the Trust will be a qualified settlement fund for federal income tax purposes. First, X has represented that the Trust will be approved by the Bankruptcy Court by the Effective Date, and the Bankruptcy Court will retain jurisdiction over the Trust during the Trust's complete administration. See § 1.468B-1(c)(1). Second, the Trust was established to resolve or satisfy tort claims brought against X for damages allegedly sustained as a result of exposure to asbestos. See § 1.468B-1(c)(2). Third, X has represented that the Trust will be a trust under state law. See § 1.468B-1(c)(3). Finally, X has represented that the Trust will only resolve or satisfy asbestos-related personal injury claims, which are allowable under § 1.468B-1(h)(2).

2. Modified Gross Income

The second requested ruling is that the Trust's modified gross income does not include certain cash or property transferred to the Trust by X.

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, interest on debt of a transferor (or a related person) is not excluded from gross income. § 1.468B-2(b)(1).

On the Effective Date, X will transfer \$g in cash and a \$r note to the Trust. The cash and the note will both be transferred to the Trust by or on behalf of X to resolve or satisfy the liabilities for which the Trust will be established (i.e., X's asbestos-related tort liabilities). Therefore, the cash transferred on the Effective Date and the principal payments on the Trust Note made by X on the predetermined dates will be excluded from the Trust's modified gross income because the amounts are transferred by or on behalf of X to the Trust to resolve or satisfy liabilities for which the Trust will be established. X's payments of interest on the Trust Note to the Trust will not be excluded from the Trust's gross income. § 1.468B-2(b)(1).

3. X's Deductions for Transfers to the Trust

The third requested ruling is that X may deduct the amount of cash transferred, including principal payments made on the Trust Note, to the Trust under §§ 162 and 461(h).¹

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. 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). 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. Settlements and judgments are also deductible when they have a business origin. *Anchor Coupling Co. v. United States*, 427 F.2d 429 (7th Cir. 1970), cert. denied, 401 U.S. 908 (1971); *Anderson v. Commissioner*, 81 F.2d 457 (10th Cir.

¹ X has not requested a ruling as to the deductibility of any other contribution to the Trust.

1936). Deductions for defending and settling claims arising from negligence have been allowed as ordinary and necessary business expenses. *Id.*; *Dancer v. Commissioner*, 73 T.C. 1103 (1980). See Rev. Rul. 78-210, 1978-1 C.B. 29 (professional medical association may deduct expenses attributable to the malpractice of its employees).

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 § 1.468B-3(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 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, § 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(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 makes a transfer to the Trust within the meaning of § 1.468B-3(a)(1) to the extent that the transfers are to satisfy liabilities described in § 1.468B-1(c)(2). To the extent X makes a transfer of cash to the Trust, X's liability is fixed and determinable with reasonable accuracy no later than the time when X makes such transfer of cash 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, X may deduct under § 162 the amount of cash transferred 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.

4. Specified Liability Losses

The fourth requested ruling is that the deductions X may take for transferring cash to the Trust qualify as specified liability losses within meaning of § 172(f).

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: (A) 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 (B) such injury, harm, or damage arises after the taxpayer has completed or terminated operations with respect to, and has relinquished possession of, such product.

Based on the information and representations submitted, if X has a net operating loss for the taxable year, the smaller of the net operating loss or X's payments to the Trust (other than interest on the Trust Note), qualifies as a "specified liability loss" within meaning of § 172(f)(1) to the extent that (1) the Trust uses such payments to make payments for Asbestos Claims to asbestos claimants, and (2) X may deduct such payments under § 162. X may carry back its specified liability loss to each year 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,

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