

**Internal Revenue Service**

Department of the Treasury  
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July 09, 2009

Legend

<u>X</u>	=	
Trust	=	
y	=	
z	=	
Court	=	
Date a	=	
State P	=	

Dear \_\_\_\_\_ :

This responds to your letter requesting certain rulings concerning the application of various sections of the Internal Revenue Code to transfers made by X to Trust. By letter dated April 15, 2009, Trust joined your request for these rulings.

FACTS

X and its subsidiaries are engaged in the trade or business of y. X has been named as a defendant in numerous actions involving personal injury or death claims caused by exposure to z-containing products for which X, its predecessors, successors and assigns has legal liability. X uses an accrual method of accounting for federal income tax purposes.

X emerged from a Chapter 11 bankruptcy proceeding pursuant to a confirmation order issued by Court dated Date a. The confirmation order, *inter alia*, confirmed a Plan of Reorganization and approved the creation of the Trust. The Plan provides that the

Court retains jurisdiction over any matter arising under or related to the Plan, including the Trust. The purpose of Trust was to resolve or satisfy present and future z-related personal injury claims brought against X. Pursuant to a permanent channeling injunction, the sole recourse of a holder of a z-related personal injury claim against X was permanently channeled to Trust, and such holder would not have any further recourse against X or certain other specified parties.

Trust was created on Date a. X represents that Trust is a trust under the law of State P. The Plan provided that Trust was to be funded by the transfer of the equity of X, other assets of X such as insurance proceeds, and future payments to be funded by the operations of the business of X. The Plan defined these future payments as Excess Cash. In general, the Plan defined Excess Cash as the earnings of X reduced by certain amounts.

## 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).

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 Court dated Date a, and the Court retains 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 claims brought against X for damages allegedly sustained as a result of exposure to z. 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).

#### Modified Gross Income

The second requested ruling is that Excess Cash transferred by or on behalf of X to the Trust is excluded from the Trust's modified gross income. 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.

Section 301 provides that a distribution of property made by a corporation to a shareholder with respect to its stock shall be treated as a dividend to the extent of its current or accumulated earnings and profits. Section 1.301-1(c) provides that § 301 is not applicable to an amount paid by a corporation to a shareholder unless the amount is paid to the shareholder in his capacity as such.

Based on the facts presented and representation made, Excess Cash transferred by or on behalf of X to the Trust is transferred to resolve or satisfy the liabilities for which the Trust is established (i.e., X's z-related liabilities). As such, Excess Cash transferred by or on behalf of X to the Trust is not a distribution by X with respect to stock within the meaning of § 301. Accordingly, pursuant to § 1.468B-2(b)(1), Excess Cash transferred by or on behalf of X to the Trust is excluded from the Trust's modified gross income.

#### X's Deductions for Transfers to the Trust

The third requested ruling is that to the extent the requirements of §§ 162 and 461(h) are otherwise met, X may deduct the amount of Excess Cash transferred to the Trust in the taxable year or years of the transfers.

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(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-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 transfers Excess Cash to the Trust to the extent that the transfers are allocable to liabilities described in § 1.468B-1(c)(2). To the extent X transfers Excess Cash to the Trust, X's liability is fixed and determinable with reasonable accuracy no later than the time when X makes such transfers. 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 Excess 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.

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.

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

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.

Sincerely,

Martin Scully, Jr.  
Senior Counsel, Branch 6  
(Income Tax & Accounting)

cc: