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LEGEND

- Agreement 1 =
- Company A =
- Company B =
- Company C =
- Company D =
- Company E =
- Company F =
- Company G =
- Company H =
- Company I =
- Court =

- Date 1 =
- Date 2 =
- Date 3 =
- Date 4 =
- Date 5 =
- Products =
- Product A =
- Product B =
- Product C =
- Settlement Plan =

- State Statute =

State X =
Taxpayer =
X =
Year 1 =
Year 2 =
Year 3 =
Year 4 =
Year 5 =
a =
b =
c =
d =
Company A Payment 1 =
Company A Payment 2 =
Company I Payment =

Dear _____ :

This letter responds to your request for a private letter ruling under §§ 468B, 162, 461 and other provisions of the Internal Revenue Code with respect to the tax consequences of a proposed transaction.

FACTS

Taxpayer is a publicly traded State X corporation and the common parent of an affiliated group the includible subsidiaries of which join in the filing of a consolidated federal income tax return. For federal income tax purposes, the affiliated group has an annual accounting period ending on December 31 and maintains its accounting books on the basis of the accrual method of accounting. Company A, a State X corporation, is a wholly-owned subsidiary of Taxpayer and wholly-owns Company B. Company B is treated as a disregarded entity for federal income tax purposes. Company B is successor by merger to a group of corporations that produced Products containing X for Product A, Product B, and Product C between Year 1 and Year 2. Various claimants have asserted, and are expected to assert in the future, tort and other claims against Company B, including claims as successor to the group of corporations that produced Products containing X, alleging X-related injuries arising out of the Products business. As successor to this group of corporations, Company B is also successor to businesses other than the Products business, which have also given rise to other claims related to those other businesses.

In Year 3, Company C, Company B's immediate predecessor, sold substantially all of the assets of its Products business to Company D, a corporation that was at the time a wholly owned indirect subsidiary of Company E ("Sale 1"). Pursuant to Sale 1,

Company D agreed to provide a net-of-insurance assumption of the liability for certain tort claims asserting X-related injuries arising out of the Products business asserted against Company C (the "Indemnified Tort Claims") and to indemnify, defend and hold harmless Company C, and its successors, net of available insurance actually collected, against any loss related to the Indemnified Tort Claims. Company E guaranteed Company D's performance of its obligations arising from its assumption and indemnification pursuant to the Agreement 1.

In Year 4, Company F purchased from Company E the stock of a successor to Company D and renamed the successor Company G. In Date 1, Company F and Company G filed petitions under Chapter 11 of the Bankruptcy Code. Company G ceased performing its obligations to Company C following its bankruptcy filing, and Company E began to satisfy these obligations under the Agreement 1. The bankruptcy court later discharged Company G from its obligations undertaken pursuant to Sale 1 and discharged Company F from its obligations undertaken pursuant to its acquisition of Company G.

In Year 5, Company C disposed of its remaining operating assets and the related liabilities and then merged into the newly-formed Company B. Company B has never conducted any business operations or owned any operating assets, but it does own insurance and indemnity rights related to the Indemnified Tort Claims and other claims asserted against Company B (the "Other Claims").

Following the Company F and Company G bankruptcy proceedings, Company B (and its affiliates, including Taxpayer) and Company H (the successor in interest to Company E) and its affiliates, have had several disputes with each other concerning the effect of certain corporate transactions, the proper scope of the Agreement 1, and the respective duties of the parties relating thereto. On Date 2, Company B commenced an action (the "Action") in the Court asserting certain claims against Company H and certain of its affiliates (the "Company B Claims"). The Company B Claims include claims for tort, breach of contract, and violation of the State Statute. Company H indicated that it would assert tort and breach of contract claims against Company B and certain of its affiliates (the "Company H Claims", and together with the Company B Claims, the "Disputed Claims"). However, the Company H Claims are not currently pending in the Action because Company B and Company H entered into an agreement on Date 3, to toll the statute of limitations with respect to the Company H Claims and to negotiate a settlement of the Disputed Claims.

Company B, its direct parent Company A, its indirect parent Taxpayer, certain other related companies, Company H and certain affiliates of Company H (collectively, the "Settling Parties") have negotiated a settlement of the Disputed Claims and intend to effectuate the transaction described below (the "Proposed Transaction").

PROPOSED TRANSACTION

Subject to the satisfaction of certain closing conditions, the Proposed Transaction will be effected pursuant to the Settlement Plan executed on Date 4 by the Settling Parties, which the Court approved in an order dated Date 5. The Proposed Transaction includes the following steps:

1. Company A and Company H will establish a trust under the state law of State X (the "Trust"). The Trust will be subject to the continuing supervision of the Court.
2. Company H will make an initial cash payment to the Trust in the amount of a (the "Initial Company H Payment") and will issue to the Trust a non-interest-bearing installment note in the principal amount of b (subject to certain adjustments) (the "Company H Note"), which will provide for payments over a period of four years (c on each of the first and second anniversaries of the closing of the Settlement Plan and d on each of the third and fourth anniversaries of such closing). The Company H Note will provide for interest payments upon the occurrence of an event of default.
3. The Settling Parties will execute a mutual release, which will include a release of the Disputed Claims and a release of Company H's obligations under the Agreement 1.
4. On the date of the closing of the transactions contemplated by the Settlement Plan (the "Closing Date"), Company A will make a cash payment of Company A Payment 1 to the Trust and a cash payment of Company A Payment 2 to Company B.
5. On the Closing Date, Company I, an indirect wholly-owned subsidiary of Taxpayer, will make a cash payment of Company I Payment to Company B.
6. On the Closing Date and immediately after steps 4 and 5 of the Proposed Transaction, Company A will assign to the Trust all of the interests in Company B, following which assignment Company B will no longer be legally owned by, or treated for federal income tax purposes as disregarded as an entity separate from, Company A. Following such assignment, Company B will instead be legally owned by, and treated for federal income tax purposes as disregarded as an entity separate from, the Trust.

After the Closing Date, Company B will remain primarily liable for Indemnified Tort Claims and the Other Claims and will retain its rights to insurance and indemnification proceeds with respect to those claims. The Initial Company H Payment and payments under the Company H Note, as well as the Company A Payment 1, will be used to fund costs related to the Indemnified Tort Claims. The Trust will advance, on Company B's behalf, defense and settlement costs relating to the Indemnified Tort Claims, and Company B will be obliged to repay those advances to the Trust if, when, and to the

extent insurance proceeds are received by Company B. The Company I Payment and the Company A Payment 2 will be used to fund costs related to the Other Claims prior to Company B receiving insurance or indemnity payments with respect to such claims, to fund costs related to the Other Claims that are not covered by insurance or indemnity, to advance funds for defense and settlement costs or judgments with respect to the Indemnified Tort Claims pending reimbursement from the Trust, and to fund related administrative expenses. These payments were required by Company H as part of the resolution of the Disputed Claims in order to ensure the continued solvency of Company B and thus its ability to defend or satisfy the Indemnified Tort Claims.

The Settlement Plan resolves fully and finally the Disputed Claims. After the dissolution of the Trust – which will occur at such time as all Indemnified Tort Claims and all other outstanding obligations of the Trust are considered satisfied, which may occur as a result of the passage of time since the most recently asserted claim, or at such other time as the termination may be mandated by applicable law – any remaining Trust assets will be distributed to an unrelated charitable organization.

Pursuant to the Settlement Plan, the Trust will indemnify Taxpayer, Company H, and their respective affiliates against claims arising out of the Proposed Transaction.

REPRESENTATIONS

Taxpayer has made the following representations with respect to the Proposed Transaction:

1. The Trust will be established as a trust under state law.
2. The Trust will be approved by and subject to the continuing jurisdiction of the Court.
3. The Trust will not be used to satisfy any excluded liabilities within the meaning of § 1.468B-1(g) (including workers' compensation claims).
4. Avoidance of any federal tax is not one of the principal purposes of the interest arrangements with respect to the Company H Note.
5. None of the Company A Payment 1, the Company A Payment 2, or the Company I Payment will represent amounts received from the settlement of an insurance claim.
6. Taxpayer, Company A, or Company H will not have any refund or reversion rights in the Trust's assets or income.
7. The aggregate fair market value of Company B's insurance and indemnity rights related to the Indemnified Tort Claims and Other Claims is exactly offset by the related

aggregate contingent liabilities. Accordingly, the net fair market value of Company B's assets is zero and will be zero at the Closing Date.

LAW AND ANALYSIS

Section 162(a) allows a deduction for all ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Payments made in settlement of lawsuits are deductible under § 162 if the acts which gave rise to the litigation were performed in the ordinary conduct of a taxpayer's business. Rev. Rul. 80-211, 1980-2 C.B. 57, and the authorities cited therein.

Section 461(a) provides that the amount of any deduction shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 461(h) 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 such item occurs.

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 468B(g)(1) 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(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-1(g) provides that a liability is not described in § 1.468B-1(c)(2) if it: (1) Arises under a workers compensation act or a self-insured health plan; (2) Is an obligation to refund the purchase price of, or to repair or replace, products regularly sold in the ordinary course of the transferor's trade or business; (3) Is an obligation of the transferor to make payments to its general trade creditors or debt holders relating to a title 11 or similar case (as defined in § 368(a)(3)(A)), or a workout; or (4) Is designated by the Commissioner in a revenue ruling or a revenue procedure.

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).

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.

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.

Section 483(a)(1) provides that in the case of any payment under any contract for the sale or exchange of any property and to which § 483 otherwise applies, there shall be treated as interest that portion of the total unstated interest under such contract which, as determined in a manner consistent with the method of computing interest under § 1272(a), is properly allocable to such payment. Section 483 applies to payments for the sale or exchange of property which constitutes part or all of the sales price and which is due more than 6 months after the date of such sale or exchange under a contract (A) under which some or all of the payments are due more than 1 year after the date of such sale or exchange, and (B) under which there is total unstated interest.

Section 1273(a) defines original issue discount (OID) as the excess of a debt instrument's stated redemption price at maturity over its issue price. If the amount of OID with respect to a debt instrument is less than a de minimis amount ($1/4$ of 1 percent of the stated redemption price at maturity multiplied by the number of complete years from the issue date of the note to the maturity date of the note), the amount of OID is treated as zero. § 1.1273-1(d). In the case of a debt instrument that is (1) not issued for money; (2) not a publicly traded debt that is issued for property; (3) not issued for publicly traded property; or (4) not a debt instrument to which § 1274 applies, the issue price is the debt instrument's stated redemption price at maturity under § 1273(b)(4). See § 1.1273-2(d).

Section 1274(a) provides that in the case of any debt instrument to which § 1274 applies, the issue price shall be, where there is adequate stated interest, the stated principal amount, or, in any other case, the imputed interest amount. Section 1274(c)(1) provides, in relevant part, that § 1274 applies to any debt instrument given in consideration for the sale or exchange of property if certain conditions are met.

Section 7872 establishes rules for the imputation of interest on certain below-market interest rate loans. The legislative history of § 7872 indicates that the term "loan" should be interpreted broadly. Any transfer of money that provides the transferor with a right to repayment may be a loan. For example, advances or deposits of all kinds may be treated as loans. H.R. Conf. Rep. No. 98-861, at 1018 (1984).

A loan is below-market under § 7872(e)(1) if it is either (A) a demand loan with interest payable on the loan at a rate less than the applicable Federal rate, or (B) a term loan where the amount loaned exceeds the present value of all payments due under the

loan. In the case of a term loan, the applicable Federal rate shall be the applicable Federal rate in effect under § 1274(d) as of the day on which the loan was made, compounded semiannually. § 7872(f)(2)(A). The lender shall be treated as having transferred on the date the loan was made and the borrower shall be treated as having received on such date, cash in an amount equal to the excess of (A) the amount loaned, over (B) the present value of all payments which are required to be made under the terms of the loan. See § 7872(b)(1). Section 7872 applies only to those below-market loans enumerated in § 7872(c)(1): (A) gifts; (B) compensation-related loans; (C) corporation-shareholder loans; (D) tax avoidance loans; (E) other below-market rate loans to the extent provided in regulations, if the interest arrangements of such loan have a significant effect on any Federal tax liability of the lender or the borrower; and (F) loans to qualified continuing care facilities.

Based on the information provided and the representations made, and for the reasons set forth below, we rule as follows:

1. 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, Taxpayer has represented that the Trust will be approved by and subject to the continuing jurisdiction of the Court. See § 1.468B-1(c)(1). Second, the Trust will be established to resolve or satisfy the Disputed Claims, which include claims for tort, breach of contract, and violation of law. See § 1.468B-1(c)(2). Third, Taxpayer has represented that the Trust will be a trust under state law. See § 1.468B-1(c)(3).
2. Company B is wholly-owned by Company A and is treated as a disregarded entity for federal income tax purposes. Accordingly, Company A will be treated as transferring all of the assets and liabilities of Company B to the Trust on the Closing Date. Based upon the Taxpayer's representation that the net fair market value of Company B's assets is zero and will be zero at the Closing Date, neither Taxpayer nor Company A will recognize taxable income by reason of the transfer of the assets and liabilities of Company B to the Trust under § 1.468B-3(a)(1).
3. Neither Taxpayer nor Company A will recognize net taxable income by reason of the Trust's receipt of the Initial Company H Payment, the Company H Note, or payments under the Company H Note.
4. Taxpayer and Company A will not recognize any taxable income due to payments by the Trust (which will include payments by Company B, which will be wholly-owned by the Trust and treated as a disregarded entity for federal income tax purposes) of Indemnified Tort Claims or Other Claims, including any claims arising out of the Proposed Transaction.
5. Company A will be entitled to a deduction under § 162 for Company A Payment 1 to resolve or satisfy liabilities described in § 1.468B-1(c)(2) in the taxable year the

payment is transferred to the Trust. Company A and Company I will be entitled to a deduction under § 162 for the Company A Payment 2 and Company I Payment, respectively, to resolve or satisfy liabilities described in § 1.468B-1(c)(2) in the taxable year in which the assets and liabilities of Company B are transferred to the Trust. Sections 162(a); 461(a); 461(h)(1); 1.461-1(a)(2); 1.468B-3(c).

6. Pursuant to the terms of the Company H Note, none of the payments on the Company H Note will contain interest, except in the case of default. Taxpayer represents that the Company H Note will not be issued under a contract for the sale or exchange of property. Rather, the Company H Note is being issued as part of the settlement of claims asserted by Taxpayer against Company E and Company H. Sections 483, 1273, 1274, 7872 do not apply to any portions of the payments on the Company H Note, excluding any portion of the payments due to default on the Company H Note. Thus, the payments on the Company H note will not be treated as imputed interest. However, we express no opinion on the tax treatment of any payments or any portion of any payments that are due to default on the Company H Note.

7. The Initial Company H Payment, the Company H Note, payments on the Company H Note (other than any payment of interest due upon an event of default, if any, with respect to the Company H Note), the Company A Payment 1, the Company A Payment 2, and the Company I Payment will be transferred to the Trust to resolve or satisfy the liabilities for which the Trust will be established. Therefore, pursuant to § 1.468B-2(b)(1), the Trust's modified gross income will exclude the amount of those transfers.

PROCEDURAL MATTERS

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, copies of this letter are being sent to your authorized representatives.

Sincerely,

Martin Scully, Jr.
Senior Counsel, Branch 6
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: