

**Internal Revenue Service**

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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable  
Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:EEE:EOET:EO1

PLR-106126-20

Date:

September 14, 2020

Legend

Trust =

Trust Agreement =

Trustee =

Administrator =

Corporation =

Incident =

Facility =

State X =

State Y =

Agency =

Action =

Year A =  
Court =  
Date 1 =  
Date 2 =  
Date 3 =  
Date 4 =  
Dollar Amount =  
State Y Code =  
Mitigation Obligation =  
State X Environmental  
Protection Law =

Dear :

This letter responds to the letter dated February 11, 2020, and subsequent amendments and correspondence submitted on behalf of the Trust, requesting certain rulings concerning the application of various sections of the Internal Revenue Code (Code)<sup>1</sup> and the Income Tax Regulations (Regulations) to the Trust. In particular, you requested the following rulings:

1. The Trust is a qualified settlement fund under Regulations section 1.468B-1(c).
2. For any taxable period where neither Corporation nor any of its affiliates are Administrator of the Trust, investment income earned by the Trust is excluded from its gross income under section 115.

The Trustee represents the facts as follows.

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<sup>1</sup> The Internal Revenue Code of 1986, as amended, to which all subsequent section references are made unless otherwise indicated.

## FACTS

Corporation owns and operates Facility located in State X. In Year A, the Incident was discovered at Facility. On Date 1 the Attorney General of State X filed the Action on behalf of the people of State X and the Agency with the Court, seeking injunctive relief and civil penalties against Corporation and full mitigation of the environmental impact of the Incident. The Action alleged violation by Corporation of various provisions of State X law. The parties to the Action also lodged a consent decree with the Court on Date 1.

The Court approved the consent decree on Date 2, pursuant to which the Corporation entered into a mitigation agreement with Agency and the Attorney General (Mitigation Agreement). The Mitigation Agreement includes the terms governing the Corporation's discharge of its Mitigation Obligation, as determined by Agency. The Court approved the establishment of the Trust to comply with certain obligations under the consent decree, and the Trust remains subject to the continuing jurisdiction of the Court.

The Trust was created by the Trust Agreement under State Y law entered into on Date 3 by Corporation and the Trustee. Agency is the sole beneficiary of the Trust. The citizens of State X and State X are indirect beneficiaries of the Trust. The Trustee was selected by Corporation with the approval of Agency. Under State Y Code, the Trustee may be removed on petitioning the applicable court of State Y by Agency. Corporation is the settlor and Administrator of the Trust. The Administrator's duties include managing the assets of the Trust in accordance with Mitigation Agreement and the Trust Agreement by negotiating all necessary agreements for the investment of the assets.

On Date 4, Corporation transferred Dollar Amount to the Trust. The Trust will use these funds for the purpose of making loans to (or other investments in) projects designed to mitigate the harm caused by the Incident (Mitigation Projects), as defined in and in accordance with the Trust Agreement and the Mitigation Agreement. The Administrator will act as the administrative agent and negotiate, manage and oversee the loan agreements of the Mitigation Projects. The Mitigation Projects are consistent with and in furtherance of Agency's programs under State X Environmental Protection Law.

Under the terms of the Trust Agreement and the Mitigation Agreement, Corporation will automatically cease to be the Administrator when Agency determines that the Mitigation Projects have met the Corporation's mitigation requirement. Upon satisfaction of the Mitigation Obligation, under the terms of the Trust Agreement, the Trustee becomes the successor Administrator and will manage the Trust in accordance with the Trust Agreement and Mitigation Agreement until the final disposition of the funds of the Trust. The Trust will ultimately distribute any funds not needed for the expenses incurred with winding up and dissolving the Trust solely to treasury accounts of State X in accordance with the Trust Agreement.

## RULINGS REQUESTED

1. The Trust is a qualified settlement fund under Regulations section 1.468B-1(c).
2. For any taxable period where neither Corporation nor any of its affiliates are Administrator of the Trust, investment income earned by the Trust is excluded from its gross income under section 115(1).

## LAW AND ANALYSIS

Issue 1 – Qualified Settlement Fund - Regulations section 1.468B-1(c)

Section 468B(g)(1) provides that “[n]othing 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.” Section 468B(g)(1) authorizes the issuance of regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise. Regulations sections 1.468B-1 through 1.468B-5 regarding qualified settlement funds were issued pursuant to section 468B(g).

Regulations section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies the three requirements of Regulations section 1.468B-1(c). First, Regulations section 1.468B-1(c)(1) requires that the fund, account, or trust is established pursuant to an order of, or it 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, Regulations section 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, Regulations section 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 represented by the Trust, the three requirements of Regulations section 1.468B-1(c) are satisfied, and as such, the Trust is a qualified settlement fund for Federal income tax purposes. First, the Court entered an order approving the establishment of the Trust and the Trust remains subject to the continuing jurisdiction of the Court. See Treas. Reg. § 1.468B-1(c)(1). Second, the Trust was established to resolve or satisfy claims of State X that arose from Corporation’s violations of State X laws which have given rise to at least one claim asserting liability. See Treas. Reg.

§ 1.468B-1(c)(2). Third, the Trust was organized as a trust under applicable state law. See Treas. Reg. § 1.468B-1(c)(3).

### Issue 2 – Income Exclusion – Section 115

Section 115(1) provides that gross income does not include income derived from any public utility or the exercise of any essential governmental function and accruing to a state or any political subdivision thereof.

Rev. Rul. 77-261, 1977-2 C.B. 45, holds that income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, is excludable from gross income for federal income tax purposes under section 115(1). The ruling reasons that the investment of cash balances by a state or political subdivision thereof in order to receive some yield on the funds until needed to meet expenses is a necessary incident of the power of the state or political subdivision to collect taxes and other revenue to fund government expenses. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign properly to conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Internal Revenue Service determined that an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) performs an essential governmental function because it protects the financial interests of the political subdivisions. The income of the organization is used to reimburse casualty losses incurred by the political subdivision or to reduce the annual fees that the member political subdivisions would otherwise be required to pay to the organization. Furthermore, upon dissolution, the organization will distribute its assets to its members. Accordingly, the income accrues to a state or political subdivision, and therefore its income is excludable from gross income under section 115(1). In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust will use its assets and income from its investments to fund the Mitigation Projects. The Mitigation Projects are consistent with and in furtherance of Agency's programs and policies required under State X Environmental Protection Law. The sole beneficiary of the Trust is Agency, on behalf of State X.

While the Corporation is participating in the Trust as the Administrator, the Trust is not performing an essential governmental function because the Corporation is benefiting more than incidentally from its participation as Administrator in satisfying its legal obligations under the Mitigation Agreement. However, upon meeting its Mitigation

Obligation, Corporation will be replaced as Administrator by an unrelated third-party, the Trustee. At such time, when neither the Corporation nor any of its affiliates is the Administrator, under the terms of the Trust Agreement and based on the representations, the Trust will be performing an essential governmental function by carrying out Agency's programs and policies.

Upon dissolution under the terms of the Trust Agreement, the Trustee will distribute any funds not needed for the expenses incurred with winding up and dissolving the Trust solely to treasury accounts of the State, in accordance with the Trust Agreement. None of Trust's assets will be distributed or revert to any entity whose income is not excludible from gross income under section 115(1).

Based solely on the facts and representations submitted by the Trustee, we conclude that when neither the Corporation nor any of its affiliates is participating in the Trust as the Administrator and is otherwise not benefiting more than incidentally from the Trust, the Trust is exercising an essential governmental function, with its income accruing to a state, a government of any possession of the United States, or political subdivision thereof. Therefore, at that time the Trust's income will be excludable from gross income under section 115(1)

This ruling letter is based on information and representations submitted on behalf of the Trust and accompanied by a penalty-of-perjury statement executed by an individual with the authority to bind the Trust, and on the understanding that there will be no material changes in the facts. This office has not verified any of the supporting materials submitted with this ruling request, and such materials are subject to verification on examination. The Associate office will revoke or modify a letter ruling retroactively if there has been a misstatement or omission of controlling facts; if the facts at the time of the transaction are materially different from the controlling facts on which the ruling letter was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. See Rev. Proc. 2020-1, § 11.05.

This letter does not address the applicability of any section of the Code or Regulations to the facts submitted, other than those sections specifically described. Further, except as expressly provided in this letter, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item of income discussed or referred to in this letter.

Because it could help resolve questions concerning federal income tax status, this letter should be kept in the Trust's permanent records.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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.

Sincerely,

David L. Marshall  
Senior Counsel  
Exempt Organizations Branch 1  
(Employee Benefits, Exempt Organizations, and  
Employment Taxes)

cc: