

Internal Revenue Service

Department of the Treasury
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Person To Contact:
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Date:
July 02, 2021

LEGEND

Taxpayer	=
Company 1	=
Company 2	=
Company 3	=
Company 4	=
Bankruptcy Court	=
Trust	=
Trustee	=
Industry	=
State A	=
State B	=
State C	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Date 7	=
Year 1	=
Number X	=
Amount Y	=

Dear _____ :

This letter responds to your letter dated December 17, 2020, requesting certain rulings concerning the application of various sections of the Internal Revenue Code and the Income Tax Regulations to Taxpayer and Trust. You have requested the following rulings that:

1. The Trust is a qualified settlement fund under Treas. Reg. § 1.468B-1.
2. The all events test and economic performance requirements are satisfied under §§ 461(a), (f), and (h) and § 1.468B-3(c) with respect to the amount of the Contribution (as defined below), and Taxpayer is entitled to claim a deduction under § 162 in the amount of the Contribution in the taxable year during which the transfer to the Trust is made.

FACTS

Taxpayer is a State A corporation and the ultimate parent of a group of entities that are included in the filing of a consolidated federal income tax return. Taxpayer's consolidated return is filed on a calendar year basis using the accrual method of accounting.

Company 1 and Company 3 are organized as State B limited liability companies, and Company 2 is organized as a State C limited liability company. Company 1, Company 2, and Company 3 are wholly and indirectly owned by Taxpayer, and each is treated as a disregarded entity for federal income tax purposes. Accordingly, each of Company 1, Company 2 and Company 3 is treated as owned by Taxpayer as their regarded owner for federal income tax purposes.

Company 2 and Company 3 were formed when Company 4, which was wholly owned by Company 1, completed a restructuring on Date 1 pursuant to which Company 2 and Company 3 were formed and Company 4 ceased to exist, as described in more detail below.

Company 4 previously manufactured and sold a variety of products primarily used in Industry (the "Products"). Company 4 was the subject of more than Number X tort claims alleging damages arising in connection with certain of the Products.

When Company 4 completed the restructuring, certain assets and liabilities of Company 4, including liabilities for Products-related tort claims (other than those liabilities for which the exclusive remedy is provided under a workers' compensation statute or similar laws) ("Claims") were transferred to Company 2, and the remaining assets and liabilities of Company 4 became assets and liabilities of Company 3. Company 2

disputes the validity and amount of the Claims. Company 2 expects that Claims will continue to be asserted against Company 2 in the future. Based on negotiations between Company 2, Company 3, and the court-appointed representatives for Products-related tort claimants, Company 2 and Company 3 believe that the aggregate amount of funding needed to fund the Trust to resolve or satisfy the Claims will likely equal or exceed Amount Y.

On Date 2, Company 2 filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court.

On Date 3, Company 2 and Company 3 agreed to establish the Trust, to be funded by Company 3 with Amount Y in cash (the "Contribution") to resolve and satisfy the Claims either (a) in connection with a Chapter 11 plan that established a trust under the Bankruptcy Code (a "Plan") or (b) if no Plan became effective, by settlement or final order outside of a Plan. The terms of the Trust are set forth in a trust agreement, the terms of which are described in further detail below, that was submitted to the Bankruptcy Court for its approval on Date 4 (the "Trust Agreement").

On Date 5, the Bankruptcy Court entered an order (the "Order") that, among other things, (i) approved the Trust Agreement, (ii) provided that the Trust shall be established in accordance with and governed by the terms of the Trust Agreement, (iii) mandated that the Trust funds be earmarked for and only used for the purposes provided in the Trust Agreement, and (iv) acknowledged and determined that the Bankruptcy Court shall be the supervisory court with respect to the Trust and shall retain jurisdiction over the Trust for the life of the Trust. On Date 6, Company 2, Company 3, and the Trustee entered into the Trust Agreement. On Date 7, Company 3 transferred the Contribution to the Trust. No portion of the Contribution represents amounts received from the settlement of an insurance claim within the meaning of § 1.468B-3(d). Further, the Trust Agreement contemplates the possibility that additional contributions may be made in the future in accordance with the purposes approved under the Trust Agreement.

Specifically, the Trust Agreement provides that the purposes of the Trust are to (i) resolve or satisfy the Claims; (ii) collect, invest, and distribute the Trust funds in accordance with the terms of the Trust Agreement; (iii) pay expenses and costs related to the administration of the Trust and any and all other liabilities of the Trust in accordance with the terms of the Trust Agreement; (iv) at all times qualify as a qualified settlement fund; and (v) otherwise administer the Trust pursuant to the express provisions of the Trust Agreement and any other agreements entered into by the Trustee or the Trust in accordance with the terms of the Trust Agreement. The Trustee is responsible for, inter alia, holding, administering, and distributing the Trust's assets in accordance with the terms of the Trust Agreement and will act as its fiduciary until the termination of the Trust.

The Trustee is also required to invest and reinvest the Trust's assets. To meet this obligation, pursuant to the Trust Agreement the Trustee's authority over the investment of the Trust's assets is delegated to the "Portfolio Manager," which will be Company 3

(or its designee). Notwithstanding this delegation to the Portfolio Manager, the Portfolio Manager's discretion is limited to investment decisions, and ultimate control over the Trust and its assets rests with the Trustee. Only the Trustee has the right to dispose of the assets in the Trust, and the Portfolio Manager's discretion with respect to investment decisions is subject to guidelines set forth in the Trust Agreement that were approved by the Bankruptcy Court.

Company 3 has limited reversion rights with respect to the Contribution and any other assets it may transfer to the Trust. These amounts, including earnings that may accrue on the Contribution amount, will be returned to Company 3 only if and when: (i) the Bankruptcy Court determines that all Claims have been paid or otherwise satisfied; or (ii) an order dissolving or otherwise terminating the Trust is issued by the Bankruptcy Court. The Trust Agreement prevents modification or amendment of the restrictions on Company 3's limited reversion rights.

Company 3 expects that all of the Contribution will be used to resolve or satisfy the Claims and therefore does not expect any assets in the Trust to revert to Company 3.

REQUESTED RULINGS

1. Trust's Status as a Qualified Settlement Fund under § 1.468B-1

Taxpayer's first requested ruling is that the Trust constitutes a qualified settlement fund under § 1.468B-1.¹

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. Sections 1.468B-1 through 1.468B-5 regarding qualified settlement funds were issued pursuant to § 468B(g).

Section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies the 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 it is approved by, the United States, any state (including the District of Columbia), territory, possession, or

¹ Ordinarily, the Service does not issue letter rulings regarding the tax consequences of a taxpayer who is not directly involved in the request if the requested letter ruling would not address the tax liability of the requester. See § 6.06 of Rev. Proc. 2020-1, 2020-1 I.R.B. 2020-1, 20. Although the Trust is not a party to this ruling request, the characterization of the Trust as a qualified settlement fund affects the timing of economic performance with respect to assets transferred by Company 3 to the Trust, and, therefore, affects the timing of deductions taken by Taxpayer for amounts transferred to the trust (see Taxpayer's second requested ruling, below).

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).

Based on the facts presented, we conclude that the Trust is a qualified settlement fund. First, the Trust was established pursuant to an order by the Bankruptcy Court and is subject to the continuing jurisdiction of the Bankruptcy Court. See § 1.468B-1(c)(1). Second, the Trust was established to resolve or satisfy tort claims for damages allegedly sustained as a result of Taxpayer's manufacture and sale of the Products. See § 1.468B-1(c)(2). Third, the Trust is organized under applicable state law. See § 1.468B-1(c)(3). Thus, the three requirements of § 1.468B-1(c) are satisfied and the Trust constitutes a qualified settlement fund under § 1.468B-1.

2. Taxpayer's Deduction for Transfers to Trust

Taxpayer's second requested ruling is that the Contribution to the Trust satisfies the all events test and economic performance requirements of §§ 461(a), (f), (h) and § 1.468B-3(c), and that Taxpayer may claim a deduction under § 162 in the amount of the Contribution in the taxable year of transfer to the Trust.

Section 162(a) of the Code provides the general rule that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. See also § 1.162-1(a).

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(f) provides that if (1) the taxpayer contests an asserted liability, (2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability, (3) the contest with respect to the asserted liability exists after the time of the transfer, and (4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year)

determined after application of § 461(h), then the deduction shall be allowed for the taxable year of the transfer. See also § 1.461-2(a)(1).

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 461(h)(4) provides that the all events test is met with respect to any item if all events have occurred which determine the fact of the liability and the amount of such liability can be determined with reasonable accuracy.

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.

Sections 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(f)(1) provides that a transferor must include in gross income any distribution it receives from a qualified settlement fund.

Section 1.468B-3(f)(3) provides that a distribution described in § 1.468B-3(f)(1) or (f)(2) is excluded from the gross income of a transferor to the extent provided by § 111(a) (regarding the recovery of tax benefit items).

Based on the facts presented, we conclude that the Contribution to the Trust satisfies the all events test and the economic performance requirements of §§ 461(a), (f), and (h). We also conclude that Taxpayer may deduct the amount of the Contribution under § 162 as an ordinary and necessary business expense in Year 1.

Economic performance occurred under § 461(h)(1) at the time of the Contribution with respect to the Claims because the Contribution satisfies the requirements of § 1.468B-3(c)(1).

The fact that Company 3 has a reversion right with respect to the Trust funds does not prevent economic performance from occurring under § 1.468B-3(c)(2)(i)(A) or (B). Under the Trust Agreement, Company 3's reversion right is not currently exercisable. Moreover, the circumstances permitting the reversion of Trust funds to Company 3 are

restricted and dependent upon events that are not certain to occur and are not illusory, and in all cases are subject to the approval of the Bankruptcy Court. See § 1.468B-3(c)(2)(i).

Taxpayer's liability with respect to the Claims is a contested liability within the meaning of § 461(f). But for the fact that the Claims are contested, a deduction would be allowed for the taxable year of the transfer. All of the events have occurred to establish the fact of Taxpayer's liability with respect to the Claims, and the amount of Taxpayer's liability can be determined with reasonable accuracy.

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 who requested 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 representatives.

A copy of this letter must be attached to any federal 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,

ROY A. HIRSCHHORN
Branch Chief, Branch 6
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: