Internal Revenue Service

Number: **202203009**
Release Date: 1/21/2022

Index Number: 61.22-00, 162.05-03, 461.01-00, 468B.02-00, 468B.06-00, 1001.00-00, 1032.00-00, 1502.13-01

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:ITA:B06
PLR-112376-20

Date:
January 22, 2021

LEGEND

Parent =

Subsidiary =

State =

Business =

Commissions =

Events =

Property A =

Property B =

Bankruptcy Court =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Effective Date =

Chapter 11 Plan =

Bar Date Order =

Confirmation Order =

Payment Agreement =

Class A Claims =

Class B Claims =

Class C Claims =

Agreement X =

Agreement Y =

Class B Claims Trust =

Class C Claims Trust =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

Dear :

This letter responds to your letter dated May 26, 2020, and supplemental correspondence, submitted on behalf of Parent and Subsidiary, regarding the application of various sections of the Internal Revenue Code (the Code) and the Income Tax Regulations to certain transactions. More specifically, Parent and Subsidiary requested several rulings related to the qualification of certain trusts as qualified settlement funds under § 1.468B-1 of the Income Tax Regulations and the tax treatment to Parent and Subsidiary of the transfer of cash, stock, and other property to the trusts.

FACTS

Parent, a State corporation, is a holding company and the common parent of an affiliated group of corporations that includes Subsidiary (the "Parent Group"). The Parent Group files a consolidated return on a calendar year basis using the accrual method of accounting. Subsidiary, a State corporation, is primarily engaged in Business in State, is the primary operating subsidiary of Parent, and is regulated by the Commissions. Parent has none of the operations, nor is directly involved in the management of Business.

Subsidiary and Parent are subject to numerous claims for damages relating to the Events, based on the premise that Subsidiary failed to repair and maintain its Property A and surrounding Property B. Under the laws of State, Subsidiary is subject to strict liability for damages resulting from the Events. The claimants include private parties, governments, and governmental entities.[1]

Parent and Subsidiary (the "Debtors") commenced voluntary cases under Chapter 11 of the Bankruptcy Code in Bankruptcy Court on Date 1 due to the substantial potential liabilities relating to the Events. The Bankruptcy Court is jointly administering the Chapter 11 cases of the Debtors. Pursuant to the Bar Date Order, all claims related to the Events were deemed to be filed against both Parent and Subsidiary for the convenience of the holders of such claims and to avoid unnecessary confusion.

Both prior to and during the Chapter 11 cases, the Debtors entered into certain settlement agreements and restructuring support agreements with various claimants and committees representing such claimants. On Date 3, the Bankruptcy Court confirmed the Chapter 11 Plan. Under the Chapter 11 Plan, the claims related to the

[1] For purposes of this ruling letter, the terms, "government" and "governmental entity" refer to any "government", "governmental entity", or "non-governmental entity treated as governmental entity" under sections 162(f)(1) and (f)(5) of the Code.

Events generally comprised three categories of claims: Class A Claims, Class B Claims,[2] and Class C Claims (collectively, "Events Claims"). The treatment of Events Claims under the Chapter 11 Plan reflects the settlements and restructuring support agreements reached with or on behalf of holders of Events Claims. The Events Claims were in dispute prior to reaching such agreements.

The Debtors represent that the Events Claims settled under the Chapter 11 Plan solely or primarily relate to Subsidiary's conduct of Business. Accordingly, Parent and Subsidiary entered Agreement X and Agreement Y confirming that any substantive liability with respect to the Events Claims (to the extent ultimately allowed) is the sole or primary liability of Subsidiary.

On Date 3, pursuant to the terms of the Chapter 11 Plan and related agreements, representatives of holders of the Class B Claims and Class C Claims established two trusts, the Class B Claims Trust and the Class C Claims Trust (collectively, “the Trusts”). The Class B Claims Trust was established under state law to administer, process, settle, resolve, liquidate, satisfy, and pay all Class B Claims as allowed in accordance with the Class B Claims Trust agreement and the procedures established for the resolution, liquidation, and payment of the Class B Claims. Pursuant to a channeling injunction, Class B Claims were permanently channeled to the Class B Claims Trust. Holders of Class B Claims must assert such claims exclusively against the Class B Claims Trust in accordance with its terms, with no recourse to the Debtors or their assets and properties. The Debtors have no residual interest in the assets of the Class B Claims Trust. In addition, pursuant to the Class B Claims Trust agreement, the Class B Claims Trust is subject to the continuing jurisdiction of the Bankruptcy Court.

Similarly, the Class C Claims Trust was established under state law to administer, process, settle, resolve, liquidate, satisfy, and pay all Class C Claims as allowed in accordance with the Class C Claims Trust agreement and the procedures established for the resolution, liquidation, and payment of the Class C Claims. Pursuant to a channeling injunction, Class C Claims were permanently channeled to the Class C Claims Trust. Holders of Class C Claims must assert such claims exclusively against the Class C Claims Trust in accordance with its terms, with no recourse to the Debtors or their assets and properties. The Debtors have no residual interest in the assets of the Class C Claims Trust and the Debtors have no legal rights in, and no control over, the disposition of the Parent stock transferred to the Class C Claims Trust. In addition, pursuant to the Class C Claims Trust agreement, the Class C Claims Trust is subject to the continuing jurisdiction of the Bankruptcy Court.

The Chapter 11 Plan became effective on Effective Date. Shortly before Effective Date and immediately thereafter, the Debtors took several steps to fulfill their responsibilities under the Chapter 11 Plan, the associated Confirmation Order, and the various

[2] Holders of Class B Claims do not include any claim holders that are a government or a governmental entity.

settlement agreements and restructuring support agreements underlying the Chapter 11 Plan.

On Date 4, Subsidiary advanced $a to the counsel for Class B Claim holders, which was used to fund the pre-Effective Date fees and expenses of the future trustee of the Class B Claims Trust.

On Effective Date, Subsidiary transferred $b to Class A Claims holders in full and final satisfaction, settlement, release and discharge of all allowed Class A Claims.

On Effective Date, Subsidiary funded the Class B Claims Trust by transferring $c directly to the Class B Claims Trust and $d to an interest-bearing escrow account owned by the Class B Claims Trust, in full and final satisfaction, release, and discharge of the Class B Claims. The escrowed amount was held for e days to generate earnings to satisfy certain other claims not included in the Class B Claims or any other claims addressed in this letter ruling request. After e days, the escrow agent transferred $d, the principal amount initially transferred to the escrow account, to the Class B Claims Trust.

Also, on Effective Date, and pursuant to the Chapter 11 Plan and Agreement Y, Parent made a capital contribution to Subsidiary consisting of Parent common stock and the proceeds of certain stock and debt offerings. On the same day, Subsidiary funded, or agreed to fund, the Class C Claims Trust with the following consideration in full and final satisfaction, release and discharge of all allowed Class C Claims:

(i) $f of cash;

(ii) g shares of Parent stock;

(iii) additional cash payments pursuant to Payment Agreement, under which Subsidiary agreed to pay an aggregate amount $h, to the Class C Claims Trust, without interest, over i years;

(iv) any proceeds payable from certain rights and potential causes of action against third parties; and

(v) the assignment of rights under certain insurance policies.

On Date 5, Subsidiary funded the Class C Claims Trust with an additional j shares of Parent stock.

In accordance with Agreement X and Agreement Y, all cash, Parent stock, and other property transferred, or to be transferred, to the Trusts have been, and will be treated, by Parent and Subsidiary as being received and then contributed by or on behalf of Subsidiary. In addition, under Agreement X and Agreement Y, Parent treated and will treat all stock, cash, and other property transferred to Subsidiary under the Chapter 11 Plan, as a contribution to the capital of Subsidiary.

Subsidiary is considering making an election under § 1.468B-1(k) (a “Grantor Trust Election”) with respect to either the Class B Claims Trust or the Class C Claims Trust, or both Trusts. In the event Subsidiary decides to make a Grantor Trust Election with respect to the Class C Claims Trust, Parent and Subsidiary intend to enter into a supplemental agreement with the Class C Claims Trust pursuant to which, among other things, Parent would agree to transfer on behalf of Subsidiary substitute shares of Parent stock (either newly issued or treasury shares) to the Class C Claims Trust (the “New Parent Shares”) as and when the Class C Claims Trust decides to dispose of a number of shares of Parent stock to a third party, and concurrently therewith the Class C Claims Trust would retransfer to Subsidiary the same number of shares of Parent stock received by the Class C Claims Trust pursuant to the Chapter 11 Plan. The Class C Claims Trust would promptly, within a commercially reasonable time thereafter, sell or exchange the New Parent Shares for cash or other property in a transaction in which the acquiror does not receive a substituted basis in such shares within the meaning of section 7701(a)(42). The shares of Parent stock retransferred to Subsidiary would be held as an additional asset of Subsidiary (with no current intent to dispose of such shares).

REPRESENTATIONS

The following representations are made with respect to the Chapter 11 Plan:

1. Subsidiary will not deduct under section 162 any amounts representing insurance policy proceeds that the Debtors recovered but excluded from gross income.

2. Because Subsidiary has not yet determined whether to make a Grantor Trust Election with respect to the Class B Claims Trust or the Class C Claims Trust, the following representations assume, as applicable, that a Grantor Trust Election is not made:

    a. The Parent stock is "publicly traded" within the meaning of § 1.170A-13(c)(7)(xi)

    b. In accordance with § 1.468B-3(e), the Parent Group will provide the Internal Revenue Service (IRS) and each administrator of the Trusts with a “§ 1.468B-3 Statement" and will include such statement in its tax return for the taxable year in which a funding of the Trusts occurs.

    c. Following the funding of the Trusts, neither the Debtors nor any "related person" to the Debtors within the meaning of section 468B(d)(3) own or will own at any time, directly or indirectly, any beneficial interest in the corpus or income or the Trusts.

RULINGS REQUESTED

1. Each of the Trusts constitutes a qualified settlement fund under § 1.468B-1(c).

2. Subsidiary is eligible to make a Grantor Trust Election with respect to each of the Trusts.

3. (a) Provided that Subsidiary does not make a Grantor Trust Election for the Class C Claims Trust, neither Subsidiary nor any other member of the Parent Group recognized or will recognize any gain or loss on the issuance or transfer of Parent stock to the Class C Claims Trust pursuant to the Chapter 11 Plan.

(b) If Subsidiary makes a Grantor Trust Election for the Class C Claims Trust, neither Subsidiary nor any other member of the Parent Group will recognize gain or loss on the issuance or transfer of the New Parent Shares to the Class C Claims Trust, or on the disposition of the New Parent Shares by the Class C Claims Trust.

4. No member of the Parent Group recognized any gain or loss upon the transfer of the Payment Agreement to the Class C Claims Trust.

5. If Subsidiary does not make a Grantor Trust Election with respect to either Trust:

(a) Subsidiary may deduct under section 162 the amounts of cash transferred by Subsidiary to the Class B Claims Trust and the Class C Claims Trust to the extent such amounts are allocable to claims by parties that are not a government or a governmental entity.

(b) Subsidiary may deduct under section 162 the principal payments (as determined for Federal income tax purposes) to be made to the Class C Claims Trust as required under Payment Agreement to the extent such payments are allocable to claims by parties that are not a government or a governmental entity.

(c) Subsidiary may deduct under section 162 an amount equal to the fair market value of Parent stock and other property transferred by Subsidiary or by Parent on behalf of Subsidiary to fund the Class C Claims Trust to the extent that these amounts are allocable to claims by parties that are not a government or a governmental entity.

(d) However, if Subsidiary makes a Grantor Trust Election with respect to the Class B Claims Trust or the Class C Claims Trust, Subsidiary may deduct under section 162 only amounts paid by the applicable Trust to the Class B or Class C claimants to resolve their claims to the extent that such amounts are paid to resolve the claims of parties that are not a government or a governmental entity.

6. If Subsidiary does not make a Grantor Trust Election with respect to either Trust, in accordance with sections 461 and 468B, Subsidiary may deduct amounts described in rulings 5(a), 5(b), and 5(c) in the taxable year in which such amounts are transferred to the Class B Claims Trust and the Class C Claims Trust, as applicable. However, if

Subsidiary makes a Grantor Trust Election with respect to the Class B Claims Trust or the Class C Claims Trust, in accordance with section 461, Subsidiary must deduct the amounts described in ruling 5(d) in the taxable year that, and only to the extent that, such amounts are paid by the Trusts to the Class B or Class C claimants, as applicable.

7. No member of the Parent Group realized discharge of indebtedness income from the settlement and discharge of Class A Claims, Class B Claims and Class C Claims.

LAW AND ANALYSIS

Ruling 1. Treatment as Qualified Settlement Funds under § 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. Sections 1.468B-1 through 1.468B-5 regarding qualified settlement funds were issued pursuant to section 468B(g).

Section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies the 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 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 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).

Section 1.468B-1(j)(1) provides that if a fund, account, or trust is established to resolve or satisfy claims described in § 1.468B-1(c)(2), the assets of the fund, account, or trust are treated as owned by the transferor of those assets until the fund, account, or trust also meets the requirements of § 1.468B-1(c)(1) and (c)(3). On the date the fund, account, or trust satisfies all the requirements of § 1.468B-1(c), the transferor is treated as transferring the assets to a qualified settlement fund.

Based on the facts presented and the representations provided herein, we conclude that the three requirements of § 1.468B-1(c) are satisfied and that each of the Trusts is

a qualified settlement fund as of the Effective Date. First, each of the Trusts was established in accordance with the Chapter 11 Plan pursuant to a confirmation order entered and approved by the Bankruptcy Court and is subject to the Bankruptcy Court's continuing jurisdiction. See § 1.468B-1(c)(1). Second, each of the Trusts was established to resolve or satisfy claims brought against Debtors for damages allegedly sustained as a result of Events. See § 1.468B-1(c)(2). Third, each of the Trusts was organized under the applicable state law. See § 1.468B-1(c)(3).

Ruling 2. Subsidiary's Eligibility to Make a Grantor Trust Election.

Section 1.468B-1(k)(1) provides that, if a qualified settlement fund has only one transferor (as defined in § 1.468B-1(d)(1)), the transferor may make an election to treat the qualified settlement fund as a trust all of which is owned by the transferor under § 671 and the regulations thereunder.

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(k)(2)(i) states the manner by which the transferor makes the Grantor Trust Election, and provides that the transferor must make the election for the taxable year in which the qualified settlement fund is established.

Section 1.468B-1(k)(3) governs the effect of making the Grantor Trust Election, providing that if the election is made: (i) Paragraph (b) of this section, and §§ 1.468B-2, 1.468B-3, and 1.468B-5(a) and (b) do not apply to the qualified settlement fund; however, this section (except for paragraph (b) of this section) and § 1.468B-4 apply to the qualified settlement fund; (ii) the qualified settlement fund is treated, for Federal income tax purposes, as a trust all of which is treated as owned by the transferor under section 671 and the regulations thereunder; (iii) the transferor must take into account in computing the transferor's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified settlement fund in accordance with § 1.671-3(a)(1); and (iv) the reporting obligations imposed by §1.671-4 on the trustee of a trust apply to the administrator.

Based on the facts presented and representations made, we conclude that Subsidiary is eligible to make a Grantor Trust Election with respect to each of the Trusts.[3] First, each

[3] Because Subsidiary is a member of a consolidated group in which Parent is the common parent, the election must be made by Parent as agent for Subsidiary. Section 1.1502-77(a)(1) provides that generally one entity (the agent) is the sole agent that is authorized to act in its own name regarding all matters relating to the Federal income tax liability for the consolidated return year for each member of the group. Under § 1.1502-77(c)(1), that agent is generally the common parent. Under § 1.1502-77(d)(1), the agent makes any election available to a subsidiary. Although Parent must make a grantor trust election for Subsidiary, the election will affect Subsidiary's separate taxable income as if Subsidiary made

Trust constitutes a qualified settlement fund as of the Effective Date pursuant to ruling 1. Second, Subsidiary is the sole transferor as defined in § 1.468B-1(d)(1) with respect to all property transferred (and to be transferred) to the Trusts, with such transfers made in satisfaction and discharge of claims which relate to, and arise out of, the business and operations of Subsidiary.

In this regard and in accordance with Agreement X and Agreement Y, all cash, Parent stock, and other property transferred, or to be transferred, to the Trusts have been, and will be treated, by Parent and Subsidiary as being received and then contributed by or on behalf of Subsidiary. In addition, under Agreement X and Agreement Y, Parent treated and will treat all stock, cash, and other property transferred to Subsidiary under the Chapter 11 Plan, as a contribution to the capital of Subsidiary.

If Subsidiary makes a Grantor Trust Election with respect to a particular Trust as contemplated in some of the rulings that follow, Subsidiary as the transferor must comply with the effect of the election as specified in § 1.468B-1(k)(3). Where a Grantor Trust election is made, the qualified settlement fund is not treated as a separate taxable entity. Section 1.468B-1(k)(3) requires Subsidiary (A) to treat the qualified settlement fund, for Federal income tax purposes, as a trust all the assets of which are treated as owned by the transferor under section 671 and the regulations thereunder, and (B) to take into account in computing its income tax liability, all items of income, deduction, and credit (including capital gains and losses) of the qualified settlement fund in accordance with § 1.671-3(a)(1). See §§ 1.468B-1(k)(3)(ii) and (iii). Section 1.468B-1(k)(3)(i) also provides that the requirements of § 1.468B-2 and § 1.468B-3 do not apply to the post-election qualified settlement fund.

Ruling 3(a). Tax Treatment Under Section 1032 of Issuance or Transfer of Parent Stock to Class C Claims Trust if Subsidiary Does Not Make Grantor Trust Election.

Section 1001(a) provides generally that gain or loss from the sale or other disposition of property is the difference between the amount realized and the basis of the property, as determined under section 1011.

Section 1001(c) states that, except as otherwise provided in Subtitle A, the entire amount of gain or loss determined under section 1001 on the sale or exchange of property shall be recognized.

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 for purposes of section 1001(a), with

---

the election and thus does not affect our conclusion that Subsidiary is eligible to make the § 1.468B-1(k) election.

the amount realized by the transferor being the fair market value of the property on the date the transfer is made.

Section 1032(a) provides that no gain or loss will be recognized to a corporation on the receipt of money or other property in exchange for stock of such corporation.

Section 1.1032-3(b)(1) provides that no gain or loss is recognized on the disposition of a corporation's stock (the "issuing corporation") by an acquiring entity in exchange for money or other property if the four requirements of § 1.1032-3(c) are met. If such requirements are met, the transaction is treated as if, immediately before the acquiring entity disposes of the stock of the issuing corporation, the acquiring entity purchased the issuing corporation's stock from the issuing corporation for fair market value with cash contributed to the acquiring entity by the issuing corporation (or, if necessary, through intermediate corporations or partnerships).

Section 1.1032-3(c) requires that, pursuant to a plan to acquire money or other property: (i) the acquiring entity acquires stock of the issuing corporation directly or indirectly from the issuing corporation in a transaction in which the tax basis of the stock of the issuing corporation in the hands of the acquiring entity would be determined, in whole or in part, with respect to the issuing corporation's basis in the issuing corporation's stock under section 362(a) or 723; (ii) the acquiring entity immediately transfers the stock of the issuing corporation to acquire money or other property (from a person other than an entity from which the stock was directly or indirectly acquired); (iii) the party receiving stock of the issuing corporation in the exchange from the acquiring entity does not receive a substituted basis in the stock of the issuing corporation within the meaning of section 7701(a)(42); and (iv) the issuing corporation stock is not exchanged for stock of the issuing corporation.

Section 1.1502-13(f)(6) provides, in general, that any loss realized by a member of a consolidated group with respect to stock of the common parent is permanently disallowed, but as to any gain realized, refers over to § 1.1032-3.

Based on the facts presented and the representations provided herein, the requirements of § 1.1032-3(c) are satisfied and we conclude that, provided that Subsidiary does not make a Grantor Trust Election for the Class C Claims Trust, neither Subsidiary nor any other member of the Parent Group recognized any gain or loss on the issuance or transfer of Parent stock to the Class C Claims Trust pursuant to the Chapter 11 Plan where the trust constitutes a qualified settlement fund as concluded under Ruling 1.

First, all amounts funded to the Trusts were funded by and on behalf of Subsidiary. The Parent stock transferred to the Class C Claims Trust was first contributed by Parent to Subsidiary pursuant to a transaction to which section 362 would apply to determine Subsidiary's basis in such stock, in the absence of § 1.1032-3(b)(1).

Second, Subsidiary immediately transferred (or was treated as transferring) the Parent stock to the Class C Claims Trust in consideration for the Class C Claims Trust's assumption of liability for the Class C Claims (in discharge of any and all liability of

Subsidiary for such claims from the holders of Class C Claims) and thus is treated as the transfer of such stock by Subsidiary to acquire property.

Third, the Class C Claims Trust took a new fair market value basis in the Parent stock received from Subsidiary, i.e., not a substituted basis under section 7701(a)(42). Fourth, the Parent stock transferred to the Class C Claims Trust was not exchanged for other stock of Parent.

Ruling 3(b). Tax Treatment Under Section 1032 of Issuance or Transfer of New Parent Stock to Class C Claims Trust if Subsidiary Makes Grantor Trust Election.

If Subsidiary makes a Grantor Trust Election with respect to the Class C Claims Trust, pursuant to § 1.468B-1(k)(3) the incidence of taxation changes from the Trust as a separate taxable entity to the Subsidiary by operation of § 1.468B-1(k)(3)(i). Section 1.468B-1(k)(3)(ii) requires that the qualified settlement fund (i.e., the applicable Trust for which the election is made) be treated by Subsidiary (the transferor), for Federal income tax purposes, as a trust all of which is treated as owned by Subsidiary under section 671 and the regulations thereunder. Additionally, § 1.468B-1(k)(3)(iii) provides that Subsidiary must take into account in computing it's income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified settlement fund (the Trust) in accordance with § 1.671-3(a)(1).

Accordingly, we conclude that, if Subsidiary makes a Grantor Trust Election with respect to the Class C Claims Trust and New Parent Shares are transferred to the Class C Claims Trust and disposed of by the Class C Claims Trust under the circumstances represented, the requirements of § 1.1032-3(c) will be satisfied with respect to the New Parent Shares. Therefore, neither Subsidiary nor any other member of the Parent Group will recognize any gain or loss on the disposition of the New Parent Shares by the Class C Claims Trust.

First, the New Parent Shares will be transferred to the Class C Claims Trust from Parent on behalf of Subsidiary in a transaction deemed to be a transfer from Parent to Subsidiary in which section 362 applies to determine Subsidiary's basis in such New Parent Shares, in the absence of § 1.1032-3(b)(1).

Second, the Class C Claims Trust will immediately sell the New Parent Shares to acquire money or other property (from a person other than an entity from which the stock was directly or indirectly acquired).

Third, the purchaser of such New Parent Shares from the Class C Claims Trust will take a fair market value basis in the Parent stock, i.e., not a substituted basis under section 7701(a)(42).

Fourth, the New Parent Shares will not be exchanged, or treated as exchanged, for other stock of Parent, in that Subsidiary (the regarded owner of the Parent stock held by

the Class C Claims Trust, being a grantor trust) would continue to own the Parent stock (now directly rather than in the trust) and the New Parent Shares will be exchanged for money or other property.

Ruling 4. No Gain or Loss upon the Transfer of the Payment Agreement to the Class C Claims Trust.

Section 1.468B-3(a)(1) provides that 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, the transfer of such property generally does not result in gain or loss to the transferor.

Based on the facts presented and the representations provided herein, we conclude that no member of the Parent Group recognized any gain or loss upon the transfer of the Payment Agreement to the Class C Claims Trust. More specifically, because the Payment Agreement is an obligation of Subsidiary to pay an amount of cash over i years, the transfer of such instrument does not result in gain or loss to Parent, Subsidiary or another member of the Parent Group.

Ruling 5. Treatment of Settlement Amounts under Section 162

Section 162(a) of the Code provides generally 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 162(f)(1) disallows a deduction for any amount paid or incurred (by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or governmental entity into the potential violation of any law. Section 162(f)(2) provides an exception to the general disallowance rule in section 162(f)(1) for certain amounts paid or incurred for restitution, remediation, or to come into compliance with a law.

Section 6.02 of Rev. Proc. 2020-1, 2020-1 I.R.B. 1, provides that the IRS ordinarily does not issue letter rulings or determination letters in certain areas because of the factual nature of the matter involved or for other reasons. This section also provides that the IRS may decline to issue a letter ruling or a determination letter when appropriate in the interest of sound tax administration, including due to resource constraints, or on other grounds whenever warranted by the facts or circumstances of a particular case.

Although Parent Group had initially requested rulings that included the application of section 162(f) to the portion of the Debtors' settlement amounts paid and property transferred to certain governments or governmental entities, this office has notified Parent Group of its determination that the provision of such ruling on this question at this time is not in the interests of sound tax administration. Accordingly, for purposes of this private letter ruling, no opinion is expressed or implied concerning the deductibility

under section 162 of any amounts paid or property transferred, or to be paid or transferred, under the Chapter 11 Plan, to any claim holder that is a “government”, a “governmental entity” or a “non-governmental entity treated as a governmental entity” under sections 162(f)(1) and (f)(5) of the Code. In addition, no opinion is expressed or implied concerning the proper allocation of amounts paid or property transferred, or to be paid or transferred, to such claim holders.

Notwithstanding the prohibition on the deduction of certain amounts under section 162(f), in order to be deductible under section 162, an expenditure must be (i) paid or incurred during the taxable year; (ii) sustained in carrying on a trade or business; (iii) an expense; (iv) a necessary expense; and (v) an ordinary expense. Commissioner v. Lincoln Savings and Loan Association, 403 U.S. 345, 352 (1971).

Whether payments in settlement of a claim are deductible under section 162 is based on the “origin of the claim.” Under this analysis, the characterization of costs depends upon the nature of the activities giving rise to the claim and does not depend on the consequence or result. See United States v. Gilmore, 372 U.S. 39 (1963) (establishing the origin of the claim test for determining whether a settlement expense was a nondeductible personal or deductible business expense); Woodward v. Commissioner, 397 U.S. 572 (1970) (stating that to determine if a business expense is ordinary and necessary or capital and nondeductible, the inquiry turns on whether the origin of the claim litigated is in the process of acquisition itself).

Consequently, amounts paid in settlement of a lawsuit are generally deductible if the acts which gave rise to the litigation were performed in the ordinary conduct of the taxpayer's business. See, e.g., Federation Bank & Trust Co. v. Commissioner, 27 T.C. 960 (1957) (allowing petitioner to deduct amounts paid in settlement of legal proceedings charging petitioner with mismanagement in the liquidation of assets); Rev. Rul. 80-211, 1980-2 C.B. 57 (allowing corporation to deduct amounts paid as punitive damages that arose from a civil lawsuit against the corporation for breach of contract and fraud in connection with the ordinary conduct of its business activities); Rev. Rul. 79-208, 1979-2 C.B. 79 (permitting taxpayer to deduct payments to settle lawsuit and obtain a release from claims under a franchise agreement).

Where both Parent and Subsidiary were named as Debtors under the Chapter 11 Plan and Confirmation Order, an initial determination must be made to determine whether Subsidiary is the appropriate party to claim a business expense deduction under section 162. Generally, a corporation may not deduct expenses paid on behalf of a related corporation. See Interstate Transit Lines v. Commissioner, 319 U.S. 590 (1943); Deputy v. Dupont, 308 U.S. 488 (1940). However, there is a limited exception to this rule. Under this exception, a corporation may deduct such expenses if they are directly and proximately related to the corporation’s own trade or business. See Young & Rubicam v. U.S., 410 F.2d 410 F.2d 1233, 1238–1239 (Ct. Cl. 1969); Austin Co. v. Comm’r, 71 T.C. 955, 967 (1979), acq., 1979-2 C.B. 1; Columbian Rope Co. v. Commissioner, 42 T.C. 800, 815-16 (1964).

Under the facts of this case, we believe that Subsidiary is the appropriate party to claim deduction for the cash and property transferred, or to be transferred, to the Trusts. As noted in the facts, Bankruptcy Court is jointly administering Parent and Subsidiary's bankruptcy cases. The Bar Date Order deemed all Class B Claims and Class C Claims to be filed against both Parent and Subsidiary for the convenience of the claimants and to avoid confusion to individual claimants. Nevertheless, these claims related to, and arose from, damages caused by Subsidiary's failure to repair and maintain Property A, property owned by Subsidiary and used to carry on its Business. Further, Subsidiary's payment of these claims was necessary to protect and preserve those business operations. In contrast, Parent operated solely as a holding company and did not directly own or operate the property related to the damage claims. Moreover, Parent was not involved in the management of Subsidiary's operations that gave rise to the Events Claims.

In addition, Agreement X and Agreement Y address the proper allocation of liabilities amongst the parties. These agreements provide that Parent will treat all cash, Parent stock and other property that it transfers to Subsidiary to fund the Trusts as capital contributions to Subsidiary. By agreeing to these terms, Parent and Subsidiary properly acknowledge that the Class B and Class C Claims are directly and proximately related to the operation of the Subsidiary's trade or business, rather than Parent's, and that the parties will treat these claims accordingly. Thus, based on the submitted information and representations made, Subsidiary is the appropriate party to claim a business expense deduction for amounts incurred for such claims under section 162.

Finally, the Class B Claims and the Class C Claims clearly arose in the ordinary course of Subsidiary's business. As discussed above, these claims resulted from damages allegedly caused by the failure of Subsidiary to repair and maintain Property A, property used in Subsidiary's business, and surrounding Property B. Accordingly, to the extent that Subsidiary's transfers of cash and Parent stock are allocable to claims held by parties that are not a government or a governmental entity, Subsidiary may deduct these amounts as ordinary and necessary business expenses under section 162.

Consequently, based on the foregoing facts and representations, and provided that Subsidiary does not make a Grantor Trust Election with respect to either Trust, it is held that:

(a) Subsidiary may deduct under section 162 the amounts of cash transferred by Subsidiary to the Class B and Class C Claims Trusts to the extent such amounts are allocable to claims by parties that are not a government or a governmental entity;

(b) Subsidiary may deduct under section 162 the principal payments (as determined for Federal income tax purposes) to be made by Subsidiary to the Class C Claims Trust pursuant to the Payment Agreement to the extent such payments

are allocable to claims by parties that are not a government or governmental entity; and

(c) Subsidiary may deduct under section 162 an amount equal to the fair market value of Parent stock and other property transferred by the Debtors to fund the Class C Claims Trust to the extent that these amounts are allocable to claims by parties that are not a government or a governmental entity.

(d) However, if Subsidiary makes a Grantor Trust Election with respect to the Class B Claims Trust or the Class C Claims Trust, Subsidiary may deduct under section 162 only amounts paid by the applicable Trust to the Class B or Class C claimants to resolve their claims to the extent that such amounts are paid to resolve the claims of parties that are not a government or a governmental entity.

Ruling 6. Accrual of Deductions under Sections 461 and 468B

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 he 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 1.461-4(g)(2) provides that if the liability of a taxpayer requires a payment or series of payments to another person and arises under any workers compensation act or out of any tort, breach of contract, or violation of law, economic performance occurs as payment is made to the person to which the liability is owed.

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 properly for purposes of section 1001. In computing the gain or loss, the amount realized by the transferor is the fair market value of the property on the dale the transferor 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.

Section 1.468B-3(c)(1) provides that, except as otherwise provided in that section, for purposes of section 461(h), economic performance occurs with respect to a liability described § 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.

Section 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 transferor that right is exercisable currently and without the agreement or an unrelated person that is independent or has an adverse interest (e.g., the court or agency that approved the fond 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-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(c)(3) provides that economic performance does not occur when a transferor transfers to a qualified settlement fund its debt (or the debt of a related person). Instead, economic performance occurs as the transferor (or related person) makes principal payments on the debt. Similarly, economic performance does not occur when a transferor transfers to a qualified settlement fund its obligation (or the obligation of a related person) to provide services or property in the future, or to make a payment described in § 1.461-4(g). Instead, economic performance with respect to such an obligation occurs as services, property or payments are provided or made to the qualified settlement fund or a claimant.

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 the facts of this case, all events will have occurred to establish the fact of Subsidiary's liabilities for Class B and Class C Claims no later than the taxable year in which Subsidiary makes transfers to the Trusts. The amounts of Subsidiary's liabilities under these claims will also be determinable with reasonable accuracy no later than such taxable year. In addition, to the extent that these claims comprise liabilities described in § 1.468B-1(c)(2), and Subsidiary does not make a Grantor Trust Election with respect to either of the Trusts, economic performance with respect to these liabilities will occur as Subsidiary makes transfers to the Trusts. As to transfers made under the Payment Agreement, if Subsidiary does not make a Grantor Trust Election with respect to the Class C Claims Trust, economic performance will occur as Subsidiary pays principal amounts to the Class C Claims Trust.

However, if Subsidiary makes a Grantor Trust Election with respect to either of the Trusts, as discussed in Ruling 2, then pursuant to § 1.468B-1(k)(3)(i), all of § 1.468B-3 is rendered inapplicable with regard to the applicable Trust. Specifically, the economic performance rule of § 1.468B-3(c)(1) will not apply to that Trust, and the general economic performance provisions of section 461 apply instead. Pursuant to section 461 and § 1.461-4(g)(2), economic performance will therefore not occur until the applicable Trust makes payments to the holders of the Class B Claims or the holders of the Class C Claims, as applicable.

Further regarding the effects of the Grantor Trust Election, § 1.468B-1(k)(3)(ii) provides that the qualified settlement fund (i.e., the applicable Trust for which the election is made) is treated, for Federal income tax purposes, as a trust all of which is treated as owned by Subsidiary (the transferor) under section 671 and the regulations thereunder. Additionally, § 1.468B-1(k)(3)(iii) provides that Subsidiary must take into account in computing its income tax liability all items of income, deduction, and credit (including capital gains and losses) of the qualified settlement fund (the applicable Trust) in accordance with § 1.671-3(a)(1).

Consequently, based on the foregoing facts and representations, it is held that:

> If Subsidiary does not make a Grantor Trust Election with respect to either Trust, in accordance with sections 461 and 468B, Subsidiary may deduct amounts described in rulings 5(a), 5(b), and 5(c) in the taxable year in which such amounts are transferred to the Class B Claims Trust and the Class C Claims Trust, as applicable. However, if Subsidiary makes a Grantor Trust Election with respect to the Class B Claims Trust or the Class C Claims Trust, in accordance with section 461, Subsidiary must deduct the amounts described in ruling 5(d), in the taxable year that, and only to the extent that, such amounts are paid by the Trusts to the Class B or Class C claimants, as applicable.

Ruling 7. Income from Discharge of Indebtedness under Section 61.

Section 61(a)(11) provides that gross income includes income from the discharge of indebtedness. Such income (also known as discharge of indebtedness income) is ordinary in nature and equals the difference between what is owed and what is actually paid to satisfy the liability.

Generally, no discharge of indebtedness income is realized upon the discharge or settlement of a contested liability. See Sobel v. Commissioner, 40 B.T.A. 1263 (1939); Zarin v. Commissioner, 916 F.2d 110 (3rd Cir. 1990); Preslar v. Commissioner, 167 F.3d 1323 (10th Cir. 1999).

Based on the facts presented and representations made, we conclude that no member of the Parent Group realized (or will realize) discharge of indebtedness income from the settlement and discharge of Class A Claims, Class B Claims and Class C Claims. Specifically, the amount of indebtedness on account of the Class A Claims, the Class B

Claims and the Class C Claims that was satisfied pursuant to the Chapter 11 Plan is equal to the amount of liability established pursuant to the relevant settlements entered into by Parent, Subsidiary and the relevant holders of such claims. Because prior to entering into each of the relevant settlements, the extent of the Debtors' liability with respect to each of the Class A Claims, the Class B Claims and the Class C Claims was in dispute, no discharge of indebtedness income is or will be realized.

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. Further, no opinion is expressed or implied concerning the deductibility under section 162 of any amounts paid or property transferred, or to be paid or transferred, under the Chapter 11 Plan, to any claim holder that is a government, a governmental entity or a non-governmental entity treated as a governmental entity under sections 162(f)(1) and (f)(5). In addition, no opinion is expressed or implied concerning the proper allocation of amounts paid or property transferred, or to be paid or transferred, to such claim holders.

Additionally, no opinion is expressed or implied concerning any transfers or payments not specifically mentioned herein, including any made by Parent or any person related to Parent.

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 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)

Enclosures (2)
A copy of this letter
A copy for § 6110 purposes

cc: