

Product Z	=	
Related Projects	=	
Trust 1	=	
Trust Y	=	
Beneficiary(ies)	=	
Trustees	=	
State	=	
LLC	=	
Dollar Amount A	=	
Dollar Amount B	=	
Dollar Amount C	=	
Dollar Amount D	=	
Dollar Amount E	=	
Percentage 1	=	
Percentage 2	=	
Percentage 3	=	

Dear _____ :

This letter responds to your letter dated December 9, 2022, submitted on behalf of Trust 1, requesting certain rulings concerning the application of various sections of the Internal Revenue Code and the Income Tax Regulations to Trust 1. Specifically, you requested the following rulings:

1. Trust 1 is a qualified settlement fund under § 1.468B-1(c);

2. Trust 1 may exclude under § 1.468B-2(b)(1) from its modified gross income the assets received or to be received; and
3. Investment income earned by Trust 1 is excluded from its gross income under § 115.

FACTS

Prior to Date 1, the Defendants were defendants in numerous court cases alleging a variety of claims regarding the Defendants' Activities in distributing Product Z. The claims included public nuisance, negligence, civil conspiracy, fraud, products liability, unfair or deceptive trade practices, false advertising, as well as violations of the Acts. Collectively, these claims are referred to as the Liabilities. Plaintiffs included the Beneficiaries. The Beneficiaries consist only of states of the United States, political subdivision of such states, the District of Columbia, and the governments of a United States possession, within the meaning of § 115.

On Date 1, the Defendants filed voluntary petitions for relief under Bankruptcy Chapter of the United States Bankruptcy Code in the Court. On Date 2, the Court approved the Defendants' Plan, and on Date 3, the Plan became effective. The Plan reflected settlements with, or on behalf of the Beneficiaries. Trust 1 resolved the Liabilities of the Defendants with respect to the Beneficiaries' claims against the Defendants for their Activities regarding Product Z.

Pursuant to the Plan, several separate trusts were to be established on Date 3, including Trust 1 and Trust Y. Trust 1 was established to receive and distribute funds on behalf of the Beneficiaries and is the subject of this letter ruling. Trust Y was established to resolve certain additional claims regarding Product Z, to act on behalf of the other trusts to collect deferred settlement obligations under the Plan, and to pursue additional assets for distribution to the other trusts in accordance with the Plan. Trust Y is not part of this ruling. The other trusts established were for other groups of beneficiaries, and those trusts are also not part of this ruling.

Prior to Date 3, the Defendants and various creditors agreed that the Defendants would advance a modest amount of money to fund advance administrative work to enable the trusts, including Trust 1, to commence efficiently on Date 3. The Court issued an order authorizing the Defendants to advance such money to fund such work on Date 4. On Date 5 and Date 6, the Defendants duly advanced Dollar Amount A on each date to an escrow agent to fund the advance work for the trusts, including Trust 1. Shortly after Date 3, the escrow agent transferred the remaining escrow balance of Dollar Amount B to Trust 1.

Trust 1 was formed on Date 3 as a State statutory trust. Trust Y is also a State statutory trust. Trust 1 and Trust Y were both formed pursuant to the Plan and remain subject to the continuing jurisdiction of the Court. The trustees of Trust 1 are the Trustees.

At the request of the Defendants and for administrative convenience, all payments from the Defendants to the separate trusts were made to Trust Y by a single electronic wire transfer to be disbursed in allocable amounts to the other trusts. As provided in the Plan, the Defendants wired Dollar Amount C to Trust Y on Date 3. The next day, Trust Y disbursed Dollar Amount D to Trust 1. Additionally, under the Plan, it is expected that Trust 1 has the right to receive future settlement funds either from the Defendants under a deferred payment agreement after the Defendants' bankruptcy reorganization, or as proceeds from the litigation or settlement of claims transferred by the Defendants to Trust Y for the benefit of certain of the trusts established under the Plan. Under the Plan, Trust Y is generally required to disburse collected funds to Trust 1 within five business days of receipt. These disbursements and proceeds are collectively referred to as the Transfers of Funds. It is expected that Trust 1 will receive funding over approximately eight years.

Under the Plan, Trust 1 also received a membership interest in LLC, which was formed to receive from the reorganized Defendants new warrants issued by them on Date 3, and to hold such warrants for future sale. The LLC holds no other assets. For administrative convenience, Trust Y momentarily held all membership interests in the LLC until its receipt of the warrants on Date 3, at which time it distributed all membership interests to the trusts formed under the Plan. Trust 1 holds Percentage 1 ownership interest. On Date 7, the LLC sold the Warrants for Dollar Amount E. The LLC will distribute to Trust 1 its allocable share of the net proceeds from the sale of the warrants.

Under the Plan, Trust 1 will devote its entire operation to abating the F created by Defendant's Activities regarding Product Z, a public health crisis, or funding Related Projects in accordance with the distribution procedures in the trust agreement for Trust 1 that benefit the Beneficiaries and their citizens or residents. Trust 1 may also hold, manage, and invest assets of the trust prior to their distribution to Beneficiaries. Other than payment for goods and services necessary for Trust 1 to perform the task of abating the F and administering Trust 1 for such purpose, none of Trust 1's income will revert to a private party. Under the terms of the trust agreement for Trust 1, the Trustees may invest and reinvest the principal and income of the trust. None of the Transfer of Funds represents dividends on stock of a transferor (or related person), interest on debt of a transferor (or a related person), or payments in compensation for late or delayed transfers.

Distributions from Trust 1 may only be made in accordance with the distribution procedures in the trust agreement. The Beneficiaries must use no less than Percentage 2 of the funds distributed from Trust 1, substantially all of such funds, on approved abatement of the F, as defined in the distribution procedures in the trust agreement for

Trust 1, and no more than Percentage 3 may be used for administrative expenses, as defined in the distribution procedures in the trust agreement for Trust 1. The approved items for the abatement of the F were created by representatives of the Beneficiaries after careful research, consideration, and deliberation. The representatives of the Beneficiaries intended that the approved items would be effective at combating the public health crisis.

Upon dissolution, any assets remaining in Trust 1 will be distributed only to the Beneficiaries in accordance with the prescribed schedule of the distribution procedures in the trust agreement for Trust 1. None of Trust 1's assets will be distributed or revert to any entity whose income is not excludible from gross income under § 115. Under the Plan, neither the Defendants nor reorganized Defendants retain any ownership or residual interest in the assets of Trust 1, any proceeds from those assets, or investment income from those assets.

RULINGS REQUESTED

1. Trust 1 is a qualified settlement fund under § 1.468B-1(c).
2. Trust 1 may exclude under § 1.468B-2(b)(1) from its modified gross income the assets received or to be received; and
3. Investment income earned by Trust 1 is excluded from its gross income under § 115.

LAW & ANALYSIS

1. Trust 1's Status as a Qualified Settlement Fund 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.” § 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 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 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 represented by Trust 1, the three requirements of § 1.468B-1(c) are satisfied, and as such, Trust 1 is a qualified settlement fund for federal income tax purposes. First, the Court entered an order approving the establishment of Trust 1, and Trust 1 remains subject to the continuing jurisdiction of the Court. See § 1.468B-1(c)(1). Second, Trust 1 was established to resolve or satisfy claims of the Beneficiaries that arose from the Defendants' violations of the Act and other Activities regarding Product Z that have given rise to the Liabilities. See § 1.468B-1(c)(2). Third, Trust 1 was organized as a trust under applicable state law. See § 1.468B-1(c)(3).

2. Transferred Funds Excluded from Modified Gross Income under § 1.468B-2(b)(1)

Section 61(a) provides that gross income means all income from whatever source derived.

Section 1.468B-2(a) provides that a qualified settlement fund is a United States person and is subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under § 1(e).

Section 1.468B-2(b) provides that the term modified gross income means "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 gross income. However, dividends on stock of a transferor (or a related person), interest on debt of a transferor (or a related person), and payments in compensation for late or delayed transfers, are not excluded from gross income.

Trust 1 was established to resolve or satisfy claims of the Beneficiaries that arose from the Defendants' Activities regarding Product Z and violations of the Act. The Transfers of Funds were and will be made to resolve or satisfy the related Liabilities. Such transfers were or will be made by the Defendants to Trust 1 through the escrow agent or through Trust Y in accordance with the terms of the Plan. As represented by Trust 1, none of the Transfers of Funds falls within the three specific exceptions to the general provision in § 1.468B-2(b)(1) that excludes transfers into the Trust from the Trust's gross income. The amount advanced by the Defendants to the escrow agent and then duly transferred to Trust 1 was for administrative costs and other incidental expenses related to the operation of Trust 1 and in furtherance of settlement of the Liabilities.

Accordingly, based on the information submitted and representations made, we conclude that Trust 1 may exclude the Transfers of Funds from its modified gross income because Trust 1 may exclude such transfers from its gross income under § 1.468B-2(b)(1).

3. Exclusion from Gross Income under § 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.

Section 115(2) provides that gross income does not include income accruing to the government of any possession of the United States, or any political subdivision thereof. Section 7701(a)(10) provides that the term "State" shall be construed to include the District of Columbia, where such construction is necessary to carry out provisions of this title.

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 § 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 to properly conduct.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115(1). In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust 1 will use its assets and income thereof to mitigate the F suffered by the Beneficiaries and their citizens as a result of Product Z. All Beneficiaries are either a State or a political subdivision thereof, the District of Columbia, or a government of a possession of the United States within the meaning of § 115. By carrying on this activity, Trust 1 is performing an essential governmental function.

Trust 1 will devote its entire operation to the purpose of funding projects to abate the F for the benefit of the Beneficiaries and their citizens. Other than payments for goods

and services necessary for Trust 1 to perform the task of mitigating F and for administering Trust 1 for this purpose, none of Trust 1 's income will revert to a private party.

Upon dissolution, Trust 1 shall distribute any funds not needed for the expenses incurred to wind up and dissolve Trust 1 solely among the Beneficiaries in accordance with the prescribed schedule of the distribution procedures in the trust agreement for Trust 1. None of Trust 1's assets will be distributed or revert to any entity that is not a State or a political subdivision thereof, the District of Columbia, or a government of a possession of the United States within the meaning of § 115.

Based solely on the facts and representations, we conclude that Trust 1 is exercising an essential governmental function, with its income accruing to a State or a political subdivision thereof, the District of Columbia, or a government of any possession of the United States. Therefore, Trust 1's income, including Trust 1's share of income or gain resulting from the LLC, is excludable from gross income § 115.

The ruling contained in this letter is based upon information and representations submitted by or on behalf of Trust 1 and accompanied by a penalty of perjury statement executed by an individual with authority to bind Trust 1 and upon the understanding that there will be no material changes in the facts. While this office has not verified any of the material submitted in support of the request for this ruling, it is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling 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. 2022-1, section 11.05.

No opinion is expressed concerning the federal tax consequences under any Code provision other than the provisions specifically cited above. 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 concerns only the federal income tax treatment of Trust 1's income and may not be cited or relied upon by any other taxpayer, including Trust 1's beneficiaries.

This ruling is directed only to Trust 1 as 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 each of Trust 1's authorized representatives.

Sincerely,

ROY A. HIRSCHHORN
Chief, Branch 6
(Income Tax & Accounting)

cc: