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Department of the Treasury

Washington, DC 20224

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Person To Contact:

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Telephone Number:

Refer Reply To:

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Date:

April 15, 2019

Legend

Act =

Agency =

Court =

Consent Decrees =

Court Order =

Harm =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Defendants =

Product Z =

Allocable Percentage =

Trust =

Beneficiary(ies) =

Trustee =

Rates

State X =

State Y =

Dollar Amount A =

Dollar Amount B =

Dollar Amount C =

Dollar Amount D =

Dollar Amount E =

Dear :

This letter responds to your letter dated June 21, 2018, 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 and the Income Tax Regulations to the Trust. In particular, you requested the following rulings:

1. The Trust is a qualified settlement fund under Treas. Reg. section 1.468B-1(c).
2. The Trust may exclude from its modified gross income, under Treas. Reg. section 1.468B-2(b)(1), the amount of certain funds transferred to the Trust after its establishment as a qualified settlement fund.
3. Investment income earned by the Trust is excluded from its gross income under I.R.C. section 115.

FACTS

The Agency filed a complaint in the Court alleging that the Defendants violated certain provisions of the Act with regard to the manufacture and design of Product Z. State X filed a separate complaint alleging that the Defendants had also violated State X laws with regard to the manufacture and design of Product Z.

The Court entered Consent Decrees on Date 1 and Date 2, pursuant to which the Defendants agreed to pay a total of Dollar Amount A, in partial settlement of the claims asserted by both Agency and State X.

Dollar Amount A would be used to fund projects designed to mitigate the Harm caused by the Defendants from the manufacture and design of Product Z (Mitigation Projects). The Allocable Percentage of Dollar Amount A would be required to be held in trust to fund Mitigation Projects for the benefit of Beneficiaries. The remaining percentage of Dollar Amount A would be required to be held in trust to fund Mitigation Projects for the benefit of a different group of beneficiaries that are not part of this ruling. Pursuant to the Consent Decrees, as later modified by the Court Order, once the court approved the trust agreement (Trust Agreement), a trust (the Trust) was to be established for the Beneficiaries and a separate trust was to be established for the beneficiaries that are not a part of this ruling.

The Defendants were to pay Dollar Amount A in four installments with respect to the Mitigation Projects. The first two installments were to be paid by the Defendants into the Court's registry (Court Registry), and after the two trusts were established, the final two installments were to be paid by the Defendants to the Court appointed Trustee who serves as the two trusts' trustee. Trustee would allocate the funds to the respective trusts in the prescribed percentages.

On Date 3 and Date 4, the Defendants deposited the first two installments (Dollar Amount B) into the Court Registry. The funds were held in the Court Registry under the Court's sole dominion and control in an interest-bearing account. Interest earned on

Dollar Amount B while held in the Court Registry did not reduce the Defendants' obligations to pay the entire Dollar Amount A as established in the Consent Decrees.

On Date 5, the Court Order approved and ordered the establishment of the two trusts. On Date 6, pursuant to the Court Order, the Trust was formed as a State Y statutory trust. At the same time, a separate trust was also formed for the benefit of the other group of beneficiaries that are not part of this ruling.

On Date 7, the Court transferred Dollar Amount B and Dollar Amount C from the Court Registry to the Trustee. Dollar Amount C represented the interest earned on Dollar Amount B while held in the Court Registry from Date 3 to Date 7. Trustee then allocated those funds to each of the two trusts in the prescribed percentages such that the Trust received the Allocable Percentage of Dollar Amount B, along with the Allocable Percentage of Dollar Amount C.

On Date 8, the Defendants transferred the third installment (Dollar Amount D) to the Trustee. Trustee then allocated the Allocable Percentage of Dollar Amount D to the Trust.

On Date 9, the Defendants transferred the fourth and final installment (Dollar Amount E) to the Trustee, and Trustee allocated the Allocable Percentage of Dollar Amount E to the Trust. The fund installments transferred to the Trust on Date 7, Date 8 and Date 9 are collectively referred to as the Transfers of Funds.

Trustee is required to establish a subaccount for each Beneficiary and fund those accounts in accordance with the Court-approved allocation percentages amongst the Beneficiaries. Trustee is also required to establish and fund subaccounts from which to pay expenses and taxes. These subaccounts are only for accounting purposes and for the allocation of funds amongst the Beneficiaries.

Trustee is to invest and reinvest the principal and the income of the Trust. Trust's assets and investment income thereof must be used to fund Mitigation Projects. Each Beneficiary must submit a Mitigation Project plan before Trust disburses funds, and every Beneficiary must use the portion of Trusts' assets allocated to it solely for Mitigation Project. Beneficiaries consist only of states and governments of possessions of the United States.

In addition to Trustee's disbursement of funds for Mitigation Projects, Trustee may disburse funds for administrative expenditures associated with implementing the Mitigation Project. Such administrative expenditures include expenditures by Beneficiaries and any third-party contractor(s). However, such administrative expenditures are not to exceed 15 percent of the total cost of the Mitigation Project.

Beneficiaries must return any unused funds to the Trust no later than the Trust's fifteenth anniversary. At such time, the Trustee shall distribute any funds not needed for the expenses incurred with winding up and dissolving the Trust solely among the Beneficiaries pursuant to the Rates described in the Trust Agreement. After this distribution, the Trustee shall distribute any remaining assets entirely among the Beneficiaries.

Pursuant to the Trust Agreement, the Defendants retain no ownership or residual interest with respect to the portion of Dollar Amount A and investment income thereof that the Trust received. The Trust Agreement further provides that the Court will be the sole and exclusive forum for enforcing the operation of the Trust and resolving disputes related thereto.

The Trust represents that none of the Transfers of Funds represents dividends on stock of a transferor (or a related person), interest on debt of a transferor (or a related person), or payments in compensation for late or delayed transfers.

RULINGS REQUESTED

1. The Trust is a qualified settlement fund under Treas. Reg. section 1.468B-1(c).
2. The Trust may exclude the Transfers of Funds from its modified gross income under Treas. Reg. section 1.468B-2(b)(1).
3. The investment income earned by the Trust is excluded from its gross income under I.R.C. section 115.

LAW AND ANALYSIS

1. Trust's Status as a Qualified Settlement Fund under Treas. Reg. 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. 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 section 1.468B-1(c). First, 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, 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, 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 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 section 1.468B-1(c)(1). Second, the Trust was established to resolve or satisfy claims of the United States and State X that arose from Defendants' violations of the Act and State X laws which have given rise to at least one claim asserting liability. See section 1.468B-1(c)(2). Third, the Trust was organized as a trust under applicable state law. See section 1.468B-1(c)(3).

2. Modified Gross Income/Transferred Funds Excluded under Treas. Reg. section 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 section 1(e).

Section 1.468B-2(b) provides that the term modified gross income means "gross income", as defined in section 61, computed with certain modifications.

Under section 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.

The Trust was established to resolve or satisfy claims of the United States and State X that arose from the Defendants' violations of the Act and State X laws. 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 the Trust via the Trustee, or from the Court Registry to the Trust via the Trustee. Further, as represented by the Trust, none of the Transfers of Funds falls within the three specific exceptions to the general provision in section 1.468B-2(b)(1) that excludes transfers into the Trust from the Trust's gross income.

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

3. I.R.C. 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.

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.

Section 7701(b)(10)(d) provides that, with certain exceptions, references in the Code to possessions of the United States shall be treated as also referring to Puerto Rico.

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 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 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 thereof to mitigate Harm suffered by Beneficiaries and their citizens. All of the Beneficiaries are either a state, or a government of a possession of the United States. By carrying on this activity, Trust is performing an essential governmental function.

Trust will devote its entire operation to the purpose of funding Mitigation Projects that benefit Beneficiaries. Other than payments for goods and services necessary for Trust to perform the task of mitigating Harm and for administering Trust for this purpose, none of Trust's income will revert to a private party.

Upon dissolution, Trustee shall distribute any funds not needed for the expenses incurred with winding up and dissolving the Trust solely among the Beneficiaries in accordance with the Rates. After this distribution, the Trustee shall distribute any remaining assets entirely among the Beneficiaries. All of the Beneficiaries are either a state or a government of a possession of the United States. None of Trust's assets will be distributed or revert to any entity whose income is not excludible from gross income under section 115.

Based solely on the facts and representations, we conclude that 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, Trust's income is excludable from gross income under section 115.

The ruling contained in this letter is based upon information and representations submitted by or on behalf of Trust and accompanied by a penalty of perjury statement executed by an individual with authority to bind Trust 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. 2019-1, 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's income and may not be cited or relied upon by any other taxpayer, including Trust's beneficiaries.

This ruling is directed only to Trust. Code 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 Trust's authorized representative.

Sincerely,

Andrew F. Megosh, Jr.
Senior Tax Law Specialist
Exempt Organizations Branch 2
Associate Chief Counsel (EEE)