

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:ITA:B06

PLR-144260-03

Date:

September 13, 2004

In Re:

| | |
|--------------------------|---|
| <u>Taxpayer</u> | = |
| <u>Date 1</u> | = |
| <u>Date 2</u> | = |
| <u>Date 3</u> | = |
| <u>Date 4</u> | = |
| <u>Date 5</u> | = |
| <u>Date 6</u> | = |
| <u>Date 7</u> | = |
| <u>Date 8</u> | = |
| <u>Date 9</u> | = |
| <u>Date 10</u> | = |
| <u>Date 11</u> | = |
| <u>police department</u> | = |
| <u>Bank</u> | = |
| <u>\$ Amount 1</u> | = |
| <u>\$ Amount 2</u> | = |
| <u>\$ Amount 3</u> | = |
| <u>A</u> | = |
| <u>B</u> | = |
| <u>C</u> | = |
| <u>D</u> | = |
| <u>E</u> | = |
| <u>F</u> | = |

Dear :

This letter responds to a letter, dated Date 1, submitted on behalf of the Taxpayer by the Taxpayer's authorized representative, requesting certain rulings under the Internal Revenue Code.

FACTS

The creation of the Taxpayer resulted as a consequence of A's criminal conduct associated with the creation of a pyramid scheme that defrauded hundreds of inventors. On Date 2, A pleaded guilty to 15 security law fraud charges relating to the creation of the pyramid scheme. On Date 3, A was sentenced and ordered to serve 15 to 75 years in prison. Below are the facts, as represented by the Taxpayer, that gave rise to A's conviction and the establishment of the Taxpayer.

On or about Date 4, the police department recovered approximately \$ Amount 1 in cash, along with various items of tangible personal property, from A's residence. The police department's seizure of the cash and tangible property coincided with its investigation and subsequent arrest of A in connection with the pyramid scheme that A operated.

After the police department seized and impounded the cash, it deposited the cash into the county's general revenue fund at Bank, where it was commingled with other funds within the county's account. As required by the police department's procedures, the cash was credited as a payable to the county's special revenue fund and designated with a separate project code.

On or about Date 5, B, C, D, E, and F filed a class action complaint asserting a variety of claims against A, including, but not limited to, breach of fiduciary duty, common law fraud, conspiracy to commit conversion, unjust enrichment, and civil racketeering.

On or about Date 6, A filed an answer to the complaint, in which he substantially denied all of these claims.

On Date 7, the police department filed a motion to intervene. Among other items addressed in the motion, the police department wanted the court to appoint a special master who would determine how to invest the cash. In response, on Date 8, the court issued an order that appointed three members to a panel that was charged with issuing an advisory report concerning the manner in which the cash should be held and invested during the course of the litigation.

On Date 9, the panel submitted its report to the court. In its report, the panel recommends, in part, that the cash be managed to provide the highest after-tax rate of

return while providing for minimal market risk. The panel's report also suggests that the court create another panel to oversee the investment of the cash using an investment manager selected from a list provided by it.

On Date 10, the court ordered that the recommendations made by the panel be adopted and that a management company be appointed to invest the cash within the parameters contained in the report. The order also gave the panel authority to approve or disapprove recommendations made by the management company regarding the investment of the cash. The cash remained in the county's account until sometime around Date 11.

On Date 11, the court issued an order stating, in pertinent part, as follows:

IT IS ORDERED, ADJUDGED, and DECREED that the Court hereby creates and establishes a Qualified Settlement Fund to be named the [Taxpayer] governed by the provisions of 26 U.S. [sic] § 468B and Treasury Regulation § 1.468B-1 from the "Monies" deposited and held by this Court until this date pursuant to the previous orders of this Court;

IT IS FURTHER ORDER ADJUDGED and DECREED that all monies shall be paid into the [Taxpayer];

IT IS FURTHER ORDERED, ADJUSTED and DECREED that in view of the damages incurred by class members and in order to expedite payment to the Class, the Court finds pursuant to NRCP 54(b) that there is no just reason for delay and the distribution of the Monies from the [Taxpayer] shall be made forthwith.

On or about Date 11, the county caused to be transferred to Taxpayer an amount equal to \$ Amount 2. Of this amount \$ Amount 3 represented interest earned on the cash while held by the county.

RULINGS REQUESTED

1. The Taxpayer is a qualified settlement fund under § 1.468B-1.
2. The Taxpayer was a qualified settlement fund on or about Date 11 when the county transferred cash to it.
3. The Taxpayer may exclude from its modified gross income \$ Amount 3 of interest earned on the seized cash while it was in the custody of the county.

ANALYSIS AND DISCUSSION OF APPLICABLE LAW

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

Section 468B(g) 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. The Secretary shall prescribe regulations providing for taxation of any such account or fund whether as a grantor trust or otherwise.” Pursuant to such authority, the Secretary has published §§ 1.468B-1 through 1.468B-5 of the Income Tax Regulations regarding qualified settlement funds (QSFs).

Under § 1.468B-1(a) and (c), a fund, account, or trust is a qualified settlement fund if (1) it is established pursuant to an order of, or 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; (2) it 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 arising out of a tort, breach of contract, or violation of law; and (3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

Under § 1.468B-1(j)(1), 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.

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.

Under § 1.468B-2(k)(2), a qualified settlement fund is in existence for the period that (i) begins on the first date on which the fund is treated as a qualified settlement fund under § 1.468B-1; and (ii) ends on the earlier of the date the fund (A) no longer satisfies the requirements of § 1.468B-1; or (B) no longer has any assets and will not receive any more transfers.

On Date 11, the Taxpayer met the first and second requirements of § 1.468B-1(c). On this date, the court entered an order approving the establishment of the fund for the purpose of resolving or satisfying the claims of the victims of the pyramid scheme. On or about Date 11, the Taxpayer met the third requirement of § 1.468B-1(c), when the county transferred cash to it. Therefore, on or about Date 11, the Taxpayer was a qualified settlement fund under § 1.468B-1. All amounts transferred by the county (including \$ Amount 3 of interest earned while in the county's custody) was transferred to resolve or satisfy the claims of the victims and none of such amount represents compensation for late or delayed transfers. Thus, under § 1.468-2(b)(1), the Taxpayer can exclude from gross income all amounts transferred to it by the county.

Accordingly, based strictly on the information submitted and representations made, we conclude:

1. The Taxpayer is a qualified settlement fund under § 1.468B-1.
2. The Taxpayer was a qualified settlement fund on or about Date 11 when the county transferred cash to it.
3. The Taxpayer may exclude from its modified gross income \$ Amount 3 of interest earned on the seized cash while it was in the custody of the county.

We express no opinion concerning the tax treatment of the interest income earned on the seized cash while such was in the custody of the county, or the tax consequences to Taxpayer, under § 6901 or any other applicable provision regarding liability as a transferee or fiduciary.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code 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 the taxpayer and its second authorized representative.

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,

Thomas A. Luxner
Branch Chief, Branch 6
(Income Tax & Accounting)

cc: