

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

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PLR-106592-05

Date:

May 16, 2005

LEGEND

Date 1 =

Trust 1 =

Trust 2 =

Facility =

City =

State =

Department =

Company =

Activity =

Year =

Years 1 =

Years 2 =

Year 3 =

X =

Year 4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Other Concerns =

Dear _____ :

This is in response to a letter dated Date 1, and subsequent correspondence, requesting a ruling that Trust 1 and Trust 2 (hereinafter "the trusts") will be treated as Qualified Settlement Funds under § 1.468B-1 of the Income Tax Regulations and that the income of the trusts will be excludible from gross income under § 115(1) of the Internal Revenue Code.

FACTS

In Year, during the excavation phase of the construction of the Facility in City, State, environmental waste was discovered. The State Department of Health (hereinafter "Department") determined that a likely source of the waste was the Company operation (located a few blocks away from the excavation site). Activity by Company had begun at a site in City in the late Years 1 and continued at that site until the late Years 2.

In Year 3, Department and Company entered into a consent decree in which Company agreed to commence cleanup of contamination caused by its Activity. Company's efforts continued over a period of X years. In Year 4, Company advised Department that it was discontinuing its cleanup efforts.

In Date 1, Department and State Attorney General filed a complaint in a State district court against Company seeking enforcement of the Year 3 consent decree and alleging violations of State's environmental laws.

In Date 2, City filed a complaint to intervene in this case. City sought relief similar to that sought by Department. City also sought relief for violations of State's environmental laws and made a claim for damages to its infrastructure (streets, etc.).

On Date 3, State, Department, City and Company entered into a Settlement Agreement. Under the terms of the settlement agreement, Company transferred ownership of the contaminated properties to City. The Settlement Agreement provides that Company will pay settlement proceeds to Trust 1 to be used to remediate the contamination caused by Company's Activity. The Settlement agreement also provides that Company will deposit settlement funds into Trust 2 to be used to alleviate Other Concerns caused by the contamination. The trusts were established to resolve or satisfy claims by the government entities relating to violations of law and the Company's breach of its Year 3 agreement. The assets that are held in trust are segregated from Company's other assets and from the assets of any related person.

On Date 4, the parties entered into a consent decree. The consent decree entered into in the State district Court authorizes the settlement agreement that establishes the trusts. The court will retain jurisdiction over the settlement agreement and the trusts. The State district court entered the consent decree as a judgment on Date 5.

The Declarations of Trusts (for both trusts) may only be amended by unanimous consent of the trustees and trustors, if necessary, in order to carry out the purposes of the trusts. The Trust 1 Declaration of Trust provides that upon termination of the trust, any remaining money shall be paid over to Trust 2. Upon termination of Trust 2, Trust 2's Declaration of Trust, specifies that any remaining money will be distributed to City.

LAW AND ANALYSIS

Section 468B

Section 1.468B-1(c) of the Income Tax Regulations provides that a fund, account, or trust is a qualified settlement fund (QSF) if it meets the following three requirements:

- (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 asserting liability (i) Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 . . . as amended, 42 U.S.C. 9601 et seq.; or (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; 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).

Section 1.468B-2(a) provides that a QSF is a United States person 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). The term "modified gross income" means gross income as defined in § 61 computed with certain modifications not relevant here. Section 61 provides, in part, that except as otherwise provided in subtitle A of the Code, gross income means all income from whatever source derived. Section 115(1) is an exception to § 61. Therefore, to the extent that the income of a QSF is described in § 115(1), that income is excluded from the QSF's modified gross income under § 1.468B-2.

To be treated as a QSF, Trust 1 and Trust 2 must satisfy all three requirements of § 1.468B-1(c).

Section 1.468B-1(c)(1) is satisfied if the fund is established pursuant to an order of, or is approved by, any agency or instrumentality (including a court of law) of any state and is subject to the continuing jurisdiction of that governmental authority. The settlement agreement and the trust documents provide for the establishment of Trust 1 and Trust

2. The settlement agreement requiring the creation of the trusts was approved by the State district court. The State district court is an instrumentality of State which is one of the United States. The State district court will have continuing jurisdiction over the trusts. Therefore, Trust 1 and Trust 2 satisfy § 1.468B-1(c)(1).

Section 1.468B-1(c)(2) is satisfied if the fund 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 arising out of a violation of law. A qualified settlement fund may be established to resolve claims described in § 1.468B-1(c)(2) as well as other types of claims (non-allowable claims) arising from the same event or series of events. See § 1.468B-1(h)(2). However, under § 1.468B-3(c), economic performance does not occur with respect to transfers to the qualified settlement fund for non-allowable claims. Trust 1 and Trust 2 were established to resolve or satisfy a number of claims made against Company by State and City as a result of an event (or related series of events) that has occurred. These claims assert liability for violations of law. Therefore, the trusts satisfy § 1.468B-1(c)(2).¹

Section 1.468B-1(c)(3) is satisfied if the assets of the fund are segregated from other assets of the transferor (and related persons). The property transferred to Trust 1 and Trust 2 is segregated from the transferor's other assets and from the assets of related persons. Therefore, Trust 1 and Trust 2 satisfy § 1.468B-1(c)(3).

Accordingly, Trust 1 and Trust 2 will qualify as QSFs under § 468B and the regulations thereunder. Because both trusts are QSFs under § 1.468B-1(c) of the regulations, they are separate taxable entities subject to tax on their modified gross income under § 1.468B-2. Modified gross income does not include income described in § 115(1).

Section 115(1)

Section 115(1) provides, in part, 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.

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

¹ The trusts have not requested a ruling as to whether, or to what extent, economic performance will occur upon the transfer of money or property to Trust 1 or Trust 2, therefore that issue will not be addressed in this letter.

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.

By funding the remediation of a contaminated and polluted site, the trusts perform an essential governmental function.

The income of the trusts will be used for purposes related to the remediation of a contaminated site. No part of either of the trusts' income will be distributed to a private party other than as payment for goods or reasonable compensation for services rendered. Upon dissolution, each trust's assets shall be distributed either to another trust the income of which is excluded from gross income under the provisions of § 115(1) or to City, a political subdivision of State.

CONCLUSIONS

Trust 1 and Trust 2 are Qualified Settlement Funds within the meaning of § 1.468B-1 of the Income Tax Regulations. The incomes of Trust 1 and Trust 2 are excludable from gross income (and modified gross income) under § 115(1) of the Code.

Except as specifically provided otherwise, no opinion is expressed on the federal tax consequences of any particular transaction. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that this ruling may not be used or cited as precedent.

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.

In accordance with the Power of Attorney on file with this office, copies of this letter are being sent to your authorized representatives.

Sincerely,

Jeffery G. Mitchell
Chief, Branch 6
(Income Tax & Accounting)