

Dear _____ :

This ruling is in response to a request by the Settlement Severance Litigation Trust (“the Trust”) for a determination that the Trust is a qualified settlement fund under Treas. Reg. § 1.468B-1, and that certain proceeds received by the Trust are excludable from the Trust’s gross income under Treas. Reg. § 1.468B-2(b)(1).

FACTS

On various dates on and after Date 1, Corporation (collectively, “the Debtor”) filed petitions under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Jurisdiction.

On Date 2, a group of the Debtor’s former employees who had been discharged in Date 3 filed a motion in the Debtor’s bankruptcy case, alleging, among other theories, wrongful discharge, and seeking an order directing the Debtor to make severance payments to them and “all others similarly situated” (“the Severance Claims”).

On Date 4, the United States Bankruptcy Trustee appointed the Committee to investigate, among other issues, employees’ claims against the Debtor and possible violations of law by the Debtor in discharging employees.

In Date 5, the Debtor, the Committee, and other parties to the proceeding reached agreement regarding the Severance Claims. The agreement provided that eligible former Debtor employees who did not opt out of the settlement (the “Settling Employees”) would receive an immediate cash payment totaling approximately \$X. Additionally, each Settling Employee would be eligible to receive a pro rata share of any net proceeds recovered in avoidance actions against certain other former Debtor employees who, shortly before the Debtor filed its Chapter 11 action, had received Payments.

On Date 6, the Bankruptcy Court entered an Order of Final Approval (“the Final Order”). Among other provisions, the Final Order authorized the Committee to commence certain Avoidance Actions on behalf of the Debtor to recover the Payments, and approved the Date 5 settlement agreement concerning the Severance Claims.

On Date 9, the Committee created the Trust under the provisions of State law to receive and subsequently distribute to the Settling Employees the proceeds of the Avoidance Actions pursuant to the Final Order.

On Date 7, the Bankruptcy Court approved the Committee’s retaining two law firms to investigate and, if appropriate, to prosecute the Avoidance Actions. From shortly thereafter until Date 8, one of the two law firms collected funds in connection with the Avoidance Actions and held those funds in a non-interest-bearing attorneys’ account. On Date 8, this law firm transferred to the Trustee gross proceeds in the amount of \$Y,

and since that date has forwarded to the Trustee, from time to time, additional proceeds as they are collected.

On Date 10, the Debtor filed in the Bankruptcy Court its Plan under Chapter 11. Included in the Plan were provisions regarding the Avoidance Actions, the Trust, and its Trustee.

On Date 11, the Bankruptcy Court issued an order (“the Confirmation Order”) confirming the Debtor’s Plan. The Confirmation Order provides, in pertinent part, that the Bankruptcy Court retains jurisdiction over “any matter arising under the Bankruptcy Code [or] arising in or related to the Chapter 11 Cases or the Plan.”

LAW AND ANALYSIS

Section 468B(g) states, “Nothing 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 statute further provides that the Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise. The Secretary has exercised this authority by publishing Treas. Reg. §§ 1.468B and 1.468B-1 through 1.468B-5 regarding qualified settlement funds.

Section 1.468B provides that a designated settlement fund, as defined in section 468B(d)(2), is taxed in the manner described in § 1.468B-2. The regulation provides further that a fund, account, or trust that does not qualify as a designated settlement is nonetheless a qualified settlement fund if it meets the requirements of a qualified settlement fund described in § 1.468B-1.

Section 1.468B-1(c) provides that a fund, account, or trust is a qualified settlement fund if it meets all of 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 (hereinafter referred to as CERCLA), 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-1(d)(1) defines a “transferor” as a person that transfers (or on whose behalf an insurer or other person transfers) money or property to a qualified settlement fund to resolve or satisfy claims described in section 1.468B-1(c)(2) against that person.

Section 1.468B-2(b)(1) provides that in general, amounts transferred to a 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. The regulation expressly excepts three sources of funds from this general income exclusion: (1) dividends on stock of a transferor (or a related person); (2) interest on debt of a transferor (or a related person); and payments in compensation for late or delayed transfers.

Section 1.468B-1(g)(3) excludes certain specified classes of liabilities from those described in § 1.468B-1(c)(2). A liability is excluded if it:

- (1) Arises under a workers compensation act or a self-insured health plan;
- (2) Is an obligation to refund the purchase price of, or to repair or replace, products regularly sold in the ordinary course of the transferor’s trade or business:
- (3) Is an obligation of the transferor to make payments to its general trade creditors or debtholders relating to a title 11 or similar case (as defined in section 368(a)(3)(A)), or a workout; or
- (4) Is designated by the Commissioner in a revenue ruling or a revenue procedure

In the current case, the Trust was approved by the Confirmation Order issued by a United States Bankruptcy Court, which has continuing jurisdiction over the Trust. The Trust was established under the laws of State to resolve employees’ wrongful discharge claims filed under potential theories of tort, breach of contract, or violation of law. Further, the discharged employees are not general trade creditors of the Debtor, nor do their claims belong to any other class excluded by the regulation. Accordingly, the Trust is a qualified settlement fund.

In this case, the Debtor is the transferor. In its Final Order, the Bankruptcy Court authorized the Committee to prosecute the Avoidance Actions on behalf of the Debtor to recover the Payments. The Bankruptcy Court subsequently approved the Committee's retaining two law firms to assist in this recovery. The law firms represented the Committee, which in turn acted on the Debtor's behalf. The amounts recovered do not fall within the three specific exceptions to the general provision that excludes transfers into the Trust from the Trust's gross income. Accordingly, the funds acquired by the law firm and turned over to the Trust are qualified transfers on behalf of the Debtor, and are excluded from the Trust's gross income.

RULINGS

1. The Trust is a qualified settlement fund under Treas. Reg. § 1.468B-1.
2. The proceeds received by the Trust and described in this request for a ruling are excludable from the Trust's gross income under Treas. Reg. § 1.468B-2(b)(1).

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.

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, copies of this letter are being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

JEFFERY G. MITCHELL
Branch Chief, Branch 6
Income Tax and Accounting