



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

UICs: 408.02-01  
408.03-00

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

SEP 28 2004

*T: EP: RA: T3*

LEGEND:

Taxpayer A =

Taxpayer B =

Company M =

Insurance Company N =

Company O =

Individual D =

Individual E =

Company P =

Company Q =

Company R =

Company S =

Company T =

Court CP =

State S =

State T =

Date 1 =

Date 2 =

Date 3 =

200452049

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Months 1 and 2 =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Amount 5 =

Amount 6 =

Dear

This is in response to a ruling request dated to your individual retirement accounts (IRAs).

concerning the status of contributions

The facts upon which you base your requests are as follows.

Taxpayer A is married to Taxpayer B. Taxpayers A and B are residents of State T. In 1997, Taxpayer A terminated employment with Company M which sponsored one or more retirement plans represented to be qualified within the meaning of section 401(a) of the Internal Revenue Code in which Taxpayer A participated. At his termination, Taxpayer A was entitled to receive distributions from said retirement plans.

In 1999, Taxpayer B also terminated employment with Company M. Taxpayer B also participated in Company M's qualified retirement plans. At her termination, Taxpayer B was entitled to receive distributions from said retirement plans.

Induced by representations made by employees of Company P, a licensed securities broker-dealer and Company Q, a registered investment advisor, Taxpayers A and B authorized Companies P and Q to manage the investment of their qualified retirement funds.

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Upon the advice of representatives of Companies P and Q, Taxpayers A and B each rolled over distributions received, respectively, from the qualified retirement plan(s) maintained by Company M into separate individual retirement annuities, described in Code section 408(b), issued by Insurance Company N. Taxpayer A rolled over Amount 1 on Dates 1 and 2, 1999. Taxpayer B rolled over Amount 2 on Date 3, Year 1999. As of Date 4, 2002, the value(s) of Taxpayers A and B's IRA annuities had decreased significantly.

Insurance Company N is a State S corporation authorized to do business in State T. Insurance Company N sells financial products primarily to individuals. Most of its sales are made through independent financial advisors, and other distribution channels including, but not limited to, investment firms and financial institutions.

On or about Date 5, 2002, Taxpayers A and B, along with other similarly situated taxpayers, filed a lawsuit in Court CP, State T, a court of competent jurisdiction, against Insurance Company N, Company O, the distributor of Insurance Company N products, Company P, Company Q, Company R, Company S, Individual D, and Individual E. Individuals D and E owned and operated Companies P, Q, R and S. The lawsuit alleged that Individuals D and E, and Companies P through S sold and/or recommended the IRA annuities purchased by Taxpayers A and B. Said lawsuit was amended on or about Date 6, 2002.

The lawsuit, as amended, contains a factual allegation to the effect that "...Each Plaintiff signed a document captioned "Group Annuity Application for Participation" for submission to Insurance Company N. These applications were either signed by Individual D or Individual E, who was listed as "agent" along with a reference to Company P as the Agent's firm. ... the reference to either Individual D or Individual E as "agent" and to Company P as "firm" on the application itself was intended to indicate that Individual D and Individual E also was acting simultaneously as an agent of Insurance Company N in procuring the sale of the annuity..."

A sample "Group Annuity Application for Participation" attached to the copy of the lawsuit submitted with Taxpayers A and B's ruling request indicates that qualified IRA annuities may be purchased from Insurance Company N.

The lawsuit, as amended, alleged that: (1) Companies P through S, and Individuals D and E breached their fiduciary duty to Taxpayers A and B by advising them to purchase and selling them IRA annuities as vehicles to receive distributions made from qualified retirement plans; (2) Insurance Company N was vicariously liable for said breaches of fiduciary duty by its agents, Company P and Individuals D and E; (3) Companies P through S and Individuals D and E defrauded Taxpayers A and B by either intentionally misrepresenting or omitting material facts from them when they sold them their IRA annuities. Furthermore, Taxpayers A and B relied upon said misrepresentations when they purchased their IRA annuities. Finally, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they made the fraudulent misrepresentations and omissions; (4) all of the named defendants committed "constructive" fraud against Taxpayers A and B in selling them their IRA annuities. Furthermore, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they committed constructive fraud; (5) Companies P through S and Individuals D and E were negligent when they sold IRA annuities to Taxpayers A and B

which negligence caused the decline in value of Taxpayers A and B's IRA annuities. Furthermore, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they negligently recommended and sold the IRA annuities to Taxpayers A and B; and (6) Companies P through S and Individuals D and E negligently misrepresented and negligently failed to disclose material facts to Taxpayers A and B when they sold them their IRA annuities which negligence caused the decline in value of Taxpayers A and B's IRA annuities. Furthermore, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they made their negligent misrepresentations and when they negligently failed to disclose material facts.

In Months 1 and 2, 2003, Taxpayers A and B entered into a settlement agreement with Insurance Company N and Company O pursuant to which Insurance Company N agreed to pay Taxpayers A and B sum(s) of money in exchange for their agreeing to the dismissal of the above-referenced Date 5, 2002, lawsuit. Under the terms of the settlement, Taxpayer A was entitled to receive Amount 3 and Taxpayer B entitled to received Amount 4. In relevant part, Article 2 of the settlement provides that "...Insurance Company N shall make separate transfers of the surrender amounts for each of the Plaintiff's Annuities to Plaintiff's respective designees within seven (7) business days after the processing of such paperwork."

From documentation contained in the file, it appears that the above-referenced settlement was the result of "arm's-length negotiations" between various parties with adverse interests.

Pursuant to the settlement agreement, the Date 5, 2002 lawsuit against Insurance Company N, Company O, Companies P through S, and Individuals D and E was dismissed.

On or about Date 5, 2003, the above referenced Amounts 3 and 4 payments were made, by check, from Insurance Company N to Taxpayers A and B. Said checks were deposited into a trust account maintained by Taxpayers A and B's counsel. On or about Date 7, 2003, checks in the amounts of Amounts 5 and 6 were issued by said counsel to Taxpayers A and B respectively. Amounts 5 and 6 represented Amounts 3 and 4 less attorney's fees.

On or about Date 8, 2003, Taxpayer A contributed Amount 5 into an IRA set up and maintained in his name with Company T. Also, on or about Date 8, 2003, Taxpayer B contributed Amount 6 into an IRA set up and maintained in her name with Company T. It has been represented that both contributory IRAs met the requirements of Code section 408(a). Said Date 8, 2003 contributions were made within 60 days of Date 5, 2003, the date Amounts 3 and 4 were paid to Taxpayers A and B.

It has been represented that, pursuant to Article 2 of the settlement agreement, the value of the respective taxpayer's (either taxpayer A's or Taxpayer B's) IRA annuity, which consisted of the respective IRA annuity value exclusive of amounts received as a result of the settlement referenced herein, less the applicable surrender charge, was transferred by Insurance Company N, by means of a direct trustee to trustee transfer, to the respective taxpayer's IRA account maintained with Company T.

It has also been represented that the sum of the settlement proceeds paid either to Taxpayer A (Amount 5) or to Taxpayer B (Amount 6) and of the amounts transferred by either Taxpayer A or

Taxpayer B to his/her IRA maintained with Company T did not exceed either Amount 1 (with respect to Taxpayer A) or Amount 2 (with respect to Taxpayer B).

Based upon the foregoing, you request the following rulings:

(1) That Taxpayer A's receipt of Amount 5 from Insurance Company N pursuant to the above described settlement of a lawsuit and its subsequent contribution into an IRA set up and maintained in his name with Company T constitutes a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code; and

(2) That Taxpayer B's receipt of Amount 6 from Insurance Company N pursuant to the above described settlement of a lawsuit and its subsequent contribution into an IRA set up and maintained in her name with Company T constitutes a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code.

With respect to the requested letter rulings, section 408(a) of the Code provides that, for purposes of this section, the term "individual retirement account" means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets certain requirements. Among these requirements is the one found in paragraph (1) of section 408(a) which states that, except in the case of a rollover contribution described in subsection (d)(3), in section 402(c), 403(a)(4), 403(b)(8), or 457 (e)(16), no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year in excess of the amount in effect for such taxable year under section 219(b)(1)(A) on behalf of any individual.

Section 408(d)(1) of the Code provides the general rule for the tax treatment of distributions from IRAs. This section provides, in pertinent part, that except as otherwise provided in subsection (d), any amount paid or distributed out of an individual retirement plan or under an individual retirement annuity shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Section 408(d)(3) of the Code establishes an exception to the contribution rules of section 408(a)(1) and the income inclusion rule of section 408(d)(1) for certain transactions characterized as rollover contributions. Under section 408(d)(3), an amount is described in paragraph (3) as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

Subparagraph (A) of section 408(d)(3) of the Code states, in pertinent part, that paragraph (1) of section 408(d) does not apply to any amount paid or distributed out of an individual retirement account or individual retirement annuity to the individual for whose benefit the account or annuity is maintained if -- (i) the entire amount received (including money and any other property) is paid into an individual retirement account or individual retirement annuity (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

Subparagraph (B) of section 408(d)(3), in short, provides that this paragraph does not apply to any amount described in subparagraph (A)(i) received by an individual from an IRA account or annuity if at any time during the 1-year period ending on the day of such receipt such individual received

any other amount described in that subparagraph from an IRA account or annuity which was not includible in his gross income because of the application of this paragraph.

With respect to the requested letter rulings, it has been represented that Taxpayers A and B, and other similarly situated taxpayers, initiated a lawsuit in a court of competent jurisdiction against various defendants named in the lawsuit, including Insurance Company N, relating to a significant loss in value of IRA annuities, described in Code section 408(b), owned by Taxpayers A and B. The lawsuit alleged various causes of said loss of value relating to activities taken either by Insurance Company N, Company O, or other named parties allegedly acting as the Agents of Insurance Company N. Said lawsuit was settled. Pursuant to said settlement, Taxpayers A and B recovered, after attorney's fees were deducted, Amounts 5 and 6, respectively, which they rolled into IRAs described in Code section 408(a) within 60 days of receipt.

The above reference settlement proceeds were designed to replace a portion of Taxpayers A and B's IRA annuity amounts lost due to alleged misconduct on the part of a number of defendants including Insurance Company N. No distribution occurred until the issuance of the checks in Amounts 3 and 4 by Insurance Company N.

Accordingly, based on the particular facts and circumstances contained herein, we hold that Taxpayers A and B's receipt of Amounts 5 and 6 from Insurance Company N as the replacement of a portion of their original IRA annuities, pursuant to the above-reference lawsuit settlement and the payment of these amounts to the newly-established individual retirement accounts at Company T, represent valid rollovers. Thus, with respect to your ruling requests, we conclude as follows;

- (1) That Taxpayer A's receipt of Amount 5 from Insurance Company N pursuant to the above described settlement of a lawsuit and its subsequent contribution into an IRA set up and maintained in his name with Company T constitutes a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code; and
- (2) That Taxpayer B's receipt of Amount 6 from Insurance Company N pursuant to the above described settlement of a lawsuit and its subsequent contribution into an IRA set up and maintained in her name with Company T constitutes a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code.

This ruling letter is based on the assumption that Taxpayers A and B's IRA annuities were described in Code section 408(b) as represented. It also assumes that the contributory IRAs set up and maintained in the names of Taxpayers A and B, described above, meet the requirements of Code section 408(a) as represented. Additionally, it assumes the correctness of all facts and representations made with respect thereto.

A copy of this letter has been sent to your authorized representatives in accordance with a power of attorney on file in this office.

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If you have any questions concerning this letter ruling, please contact \_\_\_\_\_, Esquire  
( \_\_\_\_\_ ) who may be reached at \_\_\_\_\_ (not a toll-free number) or  
(FAX).

Sincerely yours,

A handwritten signature in cursive script that reads "Frances V. Sloan". The signature is written in dark ink and is positioned above the printed name.

Frances V. Sloan, Manager,  
Employee Plans Technical Group 3

Enclosures:  
Deleted copy of this letter  
Notice of Intention to Disclose