200738025

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

UICs: 219.02-00
219.02-01
408.03.00

JUN 2 6 2007

T:EP:RA:T3

LEGEND:

Taxpayer A =

Taxpayer B =

Company M =

Company N =

Law Firm O =

Company P =

Individual D =

City S =

State T =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Amount 5 =

Amount 6 =

Amount 7 =

Amount 8 =

Fund A =

200738025

Fund B =

Fund C =

IRA T =

IRA U =

IRA V =

IRA W =

IRA X =

IRA Y =

Agreement A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Month 1 =

Month 2 =

Month 3 =

Court T =

Association U =

Number 1 =

Dear :

This is in response to a ruling request dated as supplemented by correspondence dated and submitted on your behalf by your authorized representative, concerning the status of contributions to your individual retirement accounts ("IRAs").

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

Taxpayer A, whose date of birth was Date 1, 1949, is married to Taxpayer B, whose date of birth was Date 2, 1950. Taxpayers A and B reside in City S, State T.

Taxpayer A began working for Company M on Date 3, 1968, and worked for Company M, with a break for military service, until Month 3, 1999. Taxpayer B worked for Company M from Month 1, 1969 until calendar year Taxpayers A and B participated in various retirement plans qualified within the meaning of section 401(a) of the Internal Revenue Code ("Code") while employed with Company M. Upon retirement from Company M, Taxpayers A and B rolled their Company M qualified retirement plan accounts into individual retirement accounts ("IRAs") maintained with Company N. Taxpayer A maintained IRA T and IRA U with Company N, and Taxpayer B maintained IRA V and IRA W with Company N.

Through its broker, Individual D, Company N recommended that Taxpayers A and B invest their IRA accounts in three funds, Fund A, Fund B, and Fund C, which your authorized representative characterizes as three "high risk, aggressive, mutual funds". It has been represented that, as a result of their following the recommendations of Individual D, Taxpayers A and B lost approximately 2/3 of their investments. Documentation submitted with this ruling request indicates that Taxpayer A's IRA losses approximated Amount 4, and Taxpayer B's IRA losses approximated Amount 6.

Taxpayers A and B eventually joined with approximately Number 1 other investors in a class action suit filed with Court T against Company N and Individual D. During Month 2, 2003, Taxpayers A and B agreed to have their suit removed from Court T and converted to an arbitration action against Company N and Individual D with Association U. Taxpayers A and B were represented by counsel, Law Firm O, in their actions against Company N and Individual D.

On or about Date 4, 2005, Taxpayers A and B settled their arbitration action with Company N and Individual D ("Agreement A"). As a result of the settlement, Taxpayers A and B received Amount 1 in settlement proceeds. Amount 1 represented recoupment of their IRA losses, losses associated with their investment in non-IRA accounts (Amount 7), legal costs (Amount 8), and attorney fees (Amount 2). After deducting the above-referenced non-IRA amounts, Taxpayer A received Amount 3 as an amount associated with his IRA losses, and Taxpayer B received Amount 5 associated with her IRA losses. Amount 3 is less than Amount 4, and Amount 5 is less than Amount 6.

On or about Date 5, 2005, Law Firm O received a check in the amount of Amount 1 from Company N. After deducting its fees (Amount 2) and associated legal costs (Amount 8), and after mailing Taxpayers A and B a check totaling Amount 7 (representing their non-IRA losses) Law Firm O mailed a check in the amount of Amount 3 to IRA X, an IRA set up and maintained in the name of Taxpayer A with Company P, and a check in the amount of Amount 5 to IRA Y, an IRA set up and maintained in the name of Taxpayer B with Company P. The checks were mailed to IRAs X and Y on or about Date 6, 2005. Date 6, 2005 is 31 days after Date 5, 2005.

From the documentation submitted with this ruling request, it appears that the above-referenced Agreement A was entered into pursuant to arms-length negotiation between the parties to the above-referenced arbitration action.

Based on the above facts and representations, you, through your authorized representative, request the following letter rulings:

1. That Amount 3 received by Taxpayer A from Company N pursuant to the above described Agreement A constituted a restorative payment and, as such, was eligible to be contributed into IRA X, an IRA set up and maintained in the name of Taxpayer A, and such contribution which occurred on or about Date 6, 2005, constituted a valid transaction without regard to the limitations on contributions found in Code sections 219 and 408;

2. That Amount 5 received by Taxpayer B from Company N pursuant to the above described Agreement A constituted a restorative payment and, as such, was eligible to be contributed into IRA Y, an IRA set up and maintained in the name of Taxpayer B, and such contribution which occurred on or about Date 6, 2005, constituted a valid transaction without regard to the limitations on contributions found in Code sections 219 and 408.

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.

With respect to the requested letter rulings, the initial issue presented in this case is whether the Service should treat Amounts 3 and 5 as replacing losses suffered, respectively, by Taxpayer A's IRAs T and U, and Taxpayer B's IRAs V and W and, as a result, not treat the Date 6, 2005 contributions of Amount 3 to IRA X and of Amount 5 to IRA Y as ordinary contributions subject to the limitations of Code sections 219 and 408.

A determination of whether settlement proceeds should be treated as a replacement payment, rather than an ordinary contribution, must be based on all the relevant facts and circumstances surrounding the payment of the settlement proceeds (see Revenue Ruling 2002-45, 2002-2 C.B. 116, which applies a facts and circumstances test to determine whether a payment to a qualified plan under Code section 401(a) is a restorative payment to a plan as opposed to a plan contribution). We believe that it is appropriate to apply the reasoning of Rev. Rul. 2002-45 to IRAs.

As a general rule, payments to an IRA are restorative payments only if the payments are made in order to restore some or all of the IRA losses resulting from breach of fiduciary duty, fraud or federal or state securities violations (such as payments made pursuant to a court-approved settlement or independent third party arbitration or mediation award.) In contrast, payments made to an IRA to make up for losses due to market fluctuations or poor investment returns are generally treated as contributions and not as restorative payments.

In the instant case, as noted above, Taxpayers A and B suffered heavy losses in their IRAs maintained with Company N allegedly due to the inappropriate investment advice provided by Individual D, an employee of Company N. Taxpayers A and B initially filed a suit against Company N and Individual D in Court T which court action was later converted to an arbitration action with Association U. Said arbitration action was subsequently settled pursuant to "Agreement A". As a result of Agreement A, Taxpayers A and B recovered Amount 1 from Company N. After deducting amounts not associated with their IRA losses, Taxpayers A and B recovered Amount 3 and Amount 5, respectively, from Company N representing recoupment of their IRA losses and not exceeding the amounts of their IRA losses. Amount 3 was later contributed into IRA X an IRA set up to benefit Taxpayer A; and Amount 5 was later contributed to IRA Y an IRA set up to benefit Taxpayer B.

Accordingly, from the facts presented in this case, the payments from Company N to Taxpayers A and B totaling Amount 3 and Amount 5, respectively, were the result of an arm's-length settlement of a good faith claim of liability, and, as such, constituted restorative payments rather than additional contributions to IRAs made to merely replenish IRA account balances after investment losses.

Therefore, based on the specific facts and representations contained herein, we hold that Amount 3 received by Taxpayer A from Company N, pursuant to the above-reference settlement Agreement A, was eligible to be rolled over into IRA X, an IRA set up and maintained in the name of Taxpayer A, and Amount 5 received by Taxpayer B from Company N, pursuant to the above-reference settlement Agreement A, was eligible to be rolled over into IRA Y, an IRA set up and maintained in the name of Taxpayer B.

Thus, with respect to your ruling requests, we conclude as follows;

1. That Amount 3 received by Taxpayer A from Company N pursuant to the above described Agreement A was a restorative payment eligible to be placed into IRA X, an IRA set up and maintained in the name of Taxpayer A, and such contribution which occurred on or about Date 6, 2005, constituted a valid transaction without regard to the limitations on IRA contributions found in Code sections 219 and 408;

2. That Amount 5 received by Taxpayer B from Company N pursuant to the above described Agreement A was a restorative payment eligible to be placed into IRA Y, an IRA set up and maintained in the name of Taxpayer B, and such contribution which occurred on or about Date 6, 2005, constituted a valid transaction without regard to the limitations on IRA contributions found in Code sections 219 and 408.

This ruling letter is based on the assumption that Taxpayer A's IRAs, IRA T, IRA U, and IRA X either were or are described in Code section 408(a), as represented, at all times relevant thereto. It also assumes that Taxpayer B's IRAs, IRA V, IRA W, and IRA Y, described above, either meet or met the requirements of Code section 408(a) at all times relevant thereto as represented. Additionally, it assumes the correctness of all facts and representations made with respect thereto.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations which may be applicable 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.

200738025

If you have any questions concerning this letter ruling, please contact ( ) who may be reached at 202-283- (not a toll-free number) or 202-283-9598 (FAX).

Sincerely yours,

Frances V. Sloan

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

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