Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

[Third Party Communication:
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B06
PLR-130434-16

Date: February 6, 2017

LEGEND

Parent	=
Subsidiary 1	=
Subsidiary 2	=
Subsidiary 3	=
Subsidiary 4	=
Date 1	=
Date 2	=
Date 3	=
Products	=
X	=
Year	=
State	=
Y	=

Dear :

This letter responds to your letter postmarked October 3, 2016 requesting certain rulings concerning the application of various sections of the Internal Revenue Code to Parent, Subsidiary 1, Subsidiary 2, Subsidiary 3, Subsidiary 4 (collectively, "Taxpayers"), and a trust ("Trust"). You have requested the following rulings that:

1. The Trust will constitute a qualified settlement fund under Treas. Reg. §1.468B-1.

2. Certain transfers made by Taxpayers to the Trust as contemplated by a joint plan of reorganization will be deductible by Taxpayers in the year of payment under §§ 162 and 461(h).

FACTS

Parent designs, develops, manufactures, and markets proprietary engineered industrial products. Parent is the ultimate parent of a group of subsidiary companies through which all of its business operations are conducted and that join in the filing of a consolidated federal income tax return. Parent uses an accrual method of accounting and has a taxable year that ends on December 31.

Parent has a single, wholly-owned direct subsidiary, Subsidiary 1. Subsidiary 1 operates numerous businesses through internal divisions or groups as well as through its own subsidiary entities. Subsidiary 2 and Subsidiary 3 are both direct, wholly-owned subsidiaries of Subsidiary 1, and Subsidiary 4 is a direct, wholly-owned subsidiary of Subsidiary 3.

Subsidiary 1 previously operated businesses that manufactured and sold equipment with components made by other companies, principally Products, that contained X. Subsidiary 1 received thousands of personal injury claims from individuals alleging damages from their exposure to X. Accordingly, Subsidiary 1 has thousands of such direct claims pending against it and expects to continue to receive such claims in the future.

Subsidiary 2 produces Products; some of the Products previously manufactured by Subsidiary 2 contained X. Subsidiary 2 has thousands of personal injury claims from individuals alleging damages from their exposure to X, and anticipates thousands of such claims will be asserted against it in the future.

Subsidiary 4 previously distributed Products; some of the Products previously distributed by Subsidiary 4 also contained X. Subsidiary 4 received claims from thousands of individuals alleging damages caused in part by their exposure to X. In Year, Subsidiary 4 ceased business operations, and has no assets or insurance.

Subsidiary 3 manages the defense and resolution of X-related claims against Parent and its affiliates.

Numerous individuals who asserted X-related personal injury claims against Subsidiary 2 and Subsidiary 4 (as described above) also named Parent, Subsidiary 1, and Subsidiary 3 in their complaints, alleging that these entities were also liable for injuries caused by Subsidiary 2 and Subsidiary 4 based on various theories of derivative liability, including successor, alter ego, and veil piercing liability. These derivative claims are also expected to continue to be asserted in the future.

On Date 1, Subsidiary 2, Subsidiary 3, and Subsidiary 4 filed voluntary petitions for relief under chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court.

On Date 2, Parent, Subsidiary 1, Subsidiary 2, and Subsidiary 3 reached a comprehensive settlement agreement with representatives for present and future X personal injury claimants ("Comprehensive Settlement"). On Date 3, to implement the Comprehensive Settlement, the parties filed a joint plan of reorganization under chapter 11 of the Bankruptcy Code ("Plan") that will permanently extinguish Taxpayers' and their affiliates' liability for certain present and future X-related personal injury claims ("Claims"). The Plan provides for the creation of a State statutory trust ("Trust") for the purpose of assuming liability for, receiving, processing, resolving, and paying the Claims. On the effective date of the Plan ("Effective Date"), the Claims will be assumed by the Trust.

An agreement that outlines the nature of the Trust ("Trust Agreement") is incorporated into the Plan. The sole beneficiaries of the Trust will be holders of Claims. The Plan provides that on the day immediately preceding the Effective Date, Subsidiary 2 or Subsidiary 3 will transfer a certain amount of cash to the Trust, Subsidiary 1 will transfer a certain amount of cash to Trust, and on or before the first anniversary of the Effective Date of the Plan, Subsidiary 1 will transfer a certain amount of cash to Trust. Additionally, the Plan provides that Parent, Subsidiary 1, and the Trust will enter into an agreement ("Funding Agreement") pursuant to which the Trust will have the rights to purchase from Subsidiary 1, for $1, shares of Parent common stock with a value of $Y sometime between the first and second anniversary of the Effective Date. In certain circumstances, the Funding Agreement allows for the payment of $Y in cash to the Trust in lieu of selling the Parent common stock.

Pursuant to the Trust Agreement, all monies remaining in the Trust after payment of all liabilities of the Trust shall be given to one or more organization(s) exempt from federal income tax under section 501(c)(3).

REPRESENTATIONS

Parent makes the following representations regarding the Trust:

(a) The Trust will be established to resolve or satisfy tort claims for damages allegedly sustained as a result of individuals' exposure to X.

(b) The Trust will be a trust under the laws of State.

(c) The Plan contains provisions for the creation of the Trust, which will be effective only when approved by the U.S. Bankruptcy Court and affirmed by the U.S. District Court, and will be subject to the continuing jurisdiction of the Bankruptcy Court.

(d) Neither Taxpayers, nor any related person, will own any beneficial interest, directly or indirectly, in the corpus or income of the Trust.

(e) The Trust will not be funded with amounts received by Taxpayers from the settlement of insurance claims that are excludable from Taxpayers' gross income. Furthermore, the Trust will not be funded with amounts that represent payments for prejudgment and/or postjudgment interest.

(f) Taxpayers will not have refund or reversion rights in the Trust's assets or income.

(g) The Funding Agreement is properly treated as Taxpayers' obligation to provide cash or stock in the future as described in § 1.468B-3(c)(3).

REQUESTED RULINGS

1. Trust's Status as a Qualified Settlement Fund

Parent's first requested ruling is that the Trust, upon its formation, will be a qualified settlement fund under § 1.468B-1 for federal income tax purposes.[1]

[1] Ordinarily, the Service does not issue letter rulings regarding the tax consequences of a taxpayer who is not directly involved in the request if the requested letter ruling would not address the tax liability of the requester. *See* section 6.06 of Rev. Proc. 2017-1, 2017-1 I.R.B. 2017-1, 20. Although the Trust is not a party to this ruling request, the characterization of the Trust as a qualified settlement fund affects the timing of economic performance with respect to assets transferred by Taxpayers to the Trust, and therefore affects the timing of Taxpayers' deductions for amounts transferred to the Trust (*see* Parent's second requested ruling, below).

Section 468B(g)(1) provides, in part, that 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. Pursuant to the authority of section 468B(g), the Secretary has published §§ 1.468B-1 through 1.468B-5 regarding qualified settlement funds.

Section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies the requirements of § 1.468B-1(c). First, § 1.468B-1(c)(1) requires that the fund, account, or trust is established pursuant to an order of, or it 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 continued jurisdiction of that governmental authority. Second, § 1.468B-1(c)(2) requires that the fund, account, or trust 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; (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. Third, § 1.468B-1(c)(3) provides that the fund, account, or trust must be a trust under applicable state law, or its assets must be otherwise segregated from other assets of the transferor (and related persons).

Based on the facts presented and the representations provided herein, the three requirements of § 1.468B-1(c) will be satisfied and, at that time, the Trust will be a qualified settlement fund for federal income tax purposes. First, the Trust will be approved by the Bankruptcy Court and affirmed by the district court, and the Trust will be subject to the continuing jurisdiction of the Bankruptcy Court. *See* § 1.468B-1(c)(1). Second, the Trust will be established to resolve or satisfy tort claims brought against Taxpayers for damages allegedly sustained as a result of individuals' exposure to X. *See* § 1.468B-1(c)(2). Third, the Trust will be a trust under state law. *See* § 1.468B-1(c)(3).

2. Taxpayers' Deductions for Transfers to Trust

Parent's second requested ruling is that Taxpayers may deduct the amounts transferred to the Trust under §§ 162 and 461(h), in the years those amounts are transferred.

Section 162(a) of the Code provides the general rule that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. *See also* § 1.162-1(a).

Section 461(a) provides that a deduction shall be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2) provides that, under an accrual method of accounting, a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h)(1) provides that in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to the item occurs.

Section 461(h)(4) provides that the all events test is met with respect to any item if all events have occurred which determine the fact of the liability and the amount of such liability can be determined with reasonable accuracy.

Section 1.468B-3(a)(1) provides that a transferor must treat a transfer of property to a qualified settlement fund as a sale or exchange of that property for purposes of § 1001. In computing the gain or loss, the amount realized by the transferor is the fair market value of the property on the date the transfer is made to the qualified settlement fund. Because the issuance of a transferor's debt, obligation to provide services or property in the future, or obligation to make a payment described in § 1.461–4(g), is generally not a transfer of property by the transferor, it generally does not result in gain or loss to the transferor under this paragraph (a)(1).

Section 1.468B-3(c)(1) provides that, except as otherwise provided in that section, for purposes of § 461(h), economic performance occurs with respect to a liability described in § 1.468B-1(c)(2) (determined with regard to § 1.468B-1(f) and (g)) to the extent the transferor makes a transfer to a qualified settlement fund to resolve or satisfy the liability.

Section § 1.468B-3(c)(2)(i)(A) and (B) provide that economic performance does not occur to the extent the transferor (or related person) has a right to a refund or reversion of a transfer if that right is exercisable currently and without the agreement of an unrelated person that is independent or has an adverse interest (e.g. the court or agency that approved the fund or the fund claimants), or money or property is transferred under conditions that allow its refund or reversion by reason of the occurrence of an event that is certain to occur, such as the passage of time, or if restrictions on its refund or reversion are illusory.

Section 1.468B-1(h)(2) provides that economic performance does not occur with respect to transfers to a qualified settlement fund for non-allowable claims.

Section 1.468B-3(d) provides that no deduction is allowed to a transferor for a transfer to a qualified settlement fund to the extent the transferred amounts represent amounts received from the settlement of an insurance claim and are excludable from gross income.

Section 1.468B-3(c)(3) provides that economic performance does not occur when a transferor transfers to a qualified settlement fund its debt (or the debt of a related person). Instead, economic performance occurs as the transferor (or related person) makes principal payments on the debt. Similarly, economic performance does not occur when a transferor transfers to a qualified settlement fund its obligation (or the obligation of a related person) to provide services or property in the future, or to make a payment described in § 1.461–4(g). Instead, economic performance with respect to such an obligation occurs as services, property or payments are provided or made to the qualified settlement fund or a claimant.

Based on the facts represented, the amounts transferred to the Trust will be used to satisfy the Claims, which are liabilities described in § 1.468B-1(c)(2). These liabilities arose as a result of Taxpayers' principal business activities. Thus, such amounts will be deductible under § 162(a) as ordinary and necessary business expenses.

To the extent that the all events tests under § 1.461-1(a)(2), including economic performance, are met, the amounts transferred to the Trust will be deductible in the taxable year of the transfer. With respect to the transfers of cash described in the Plan, Taxpayers' liability is fixed and determinable with reasonable accuracy, and economic performance will occur at the time the cash is transferred to the Trust. Furthermore, to the extent Parent and/or Subsidiary 1 transfer cash or stock to the Trust pursuant to the Funding Agreement, the liability of Parent and/or Subsidiary 1 liability will be fixed and determinable with reasonable accuracy, and economic performance will occur at the time the cash or stock is transferred pursuant to § 1.468B-3(c)(3).

Therefore, we conclude that Taxpayers may deduct under § 162 the amount of cash and the value of stock transferred to the Trust in the taxable year or years of the transfers, but only to the extent that (i) the transfers are made to resolve or satisfy a liability described in § 1.468B-1(c)(2) and (ii) the transferred amounts do not represent amounts received from the settlement of an insurance claim which is excludable from Taxpayers' gross income.

PROCEDURAL MATTERS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) 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 Parent's authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by Parent 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,

Roy Hirschhorn
Chief, Branch 6
Office of Associate Chief Counsel
(Income Tax & Accounting)