

return for its taxable year ending October 31, 1993.

*Example 5.* Assume the same facts as in *Example 4*, except that the court approves the settlement on May 1, 1994. The administrator must attach the relation-back election statement to the fund's income tax return for calendar year 1994, and Corporation X must attach the election statement to its original or amended income tax return for its taxable year ending October 31, 1994. Pursuant to this election, the fund begins its existence as a qualified settlement fund on January 1, 1994. In addition, Corporation X is treated as transferring to the qualified settlement fund all amounts held in the fund on January 1, 1994. With respect to the transfer, Corporation X must provide the statement described in § 1.468B-3(e) to the administrator of the qualified settlement fund by February 15, 1995, and must attach a copy of this statement to its income tax return for its taxable year ending October 31, 1994.

*Example 6.* Corporation Z establishes a fund that meets all the requirements of section 468B(d)(2) for a designated settlement fund, except that Corporation Z does not make the election under section 468B(d)(2)(F). Although the fund does not qualify as a designated settlement fund, it is a qualified settlement fund because the fund meets the requirements of paragraph (c) of this section.

*Example 7.* Corporation X owns and operates a landfill in State A. State A requires Corporation X to transfer money to a trust annually based on the total tonnage of material placed in the landfill during the year. Under the laws of State A, Corporation X will be required to perform (either itself or through contractors) specified closure activities when the landfill is full, and the trust assets will be used to reimburse Corporation X for those closure costs. The trust is not a qualified settlement fund because it is established to secure the liability of Corporation X to perform the closure activities.

[T.D. 8459, 57 FR 60989, Dec. 23, 1992; 58 FR 7865, Feb. 10, 1993]

**§ 1.468B-2 Taxation of qualified settlement funds and related administrative requirements.**

(a) *In general.* A qualified settlement fund is a United States person and is 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 section 1(e).

(b) *Modified gross income.* The "modified gross income" of a qualified settlement fund is its gross income, as defined in section 61, computed with the following modifications—

(1) In general, amounts transferred to the 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. However, dividends on stock of a transferor (or a related person), interest on debt of a transferor (or a related person), and payments in compensation for late or delayed transfers, are not excluded from gross income.

(2) A deduction is allowed for administrative costs and other incidental expenses incurred in connection with the operation of the qualified settlement fund that would be deductible under chapter 1 of the Internal Revenue Code in determining the taxable income of a corporation. Administrative costs and other incidental expenses include state and local taxes, legal, accounting, and actuarial fees relating to the operation of the qualified settlement fund, and expenses arising from the notification of claimants and the processing of their claims. Administrative costs and other incidental expenses do not include legal fees incurred by, or on behalf of, claimants.

(3) A deduction is allowed for losses sustained by the qualified settlement fund in connection with the sale, exchange, or worthlessness of property held by the fund to the extent the losses would be deductible in determining the taxable income of a corporation under section 165 (f) or (g), and sections 1211(a) and 1212(a).

(4) A deduction is allowed for the amount of a net operating loss of the qualified settlement fund to the extent the loss would be deductible in determining the taxable income of a corporation under section 172(a). For purposes of this paragraph (b)(4), the net operating loss of a qualified settlement fund for a taxable year is the amount by which the deductions allowed under paragraphs (b)(2) and (b)(3) of this section exceed the gross income of the fund computed with the modification described in paragraph (b)(1) of this section.

(c) *Partnership interests held by a qualified settlement fund on February 14, 1992—*(1) *In general.* For taxable years ending prior to January 1, 2003, a qualified settlement fund that holds a partnership interest it acquired prior to

February 15, 1992, is allowed a deduction for its distributive share of that partnership's items of loss, deduction, or credit described in section 702(a) that would be deductible in determining the taxable income (or in the case of a credit, the income tax liability) of a corporation to the extent of the fund's distributive share of that partnership's items of income and gain described in section 702(a) for the same taxable year. For purposes of this paragraph (c)(1), a distributive share of a partnership credit is treated as a deduction in an amount equal to the amount of the credit divided by the rate described in paragraph (a) of this section.

(2) *Limitation on changes in partnership agreements and capital contributions.* For purposes of paragraph (c)(1) of this section, changes in a qualified settlement fund's distributive share of items of income, gain, loss, deduction, or credit are disregarded if—

(i) They result from a change in the terms of the partnership agreement on or after December 18, 1992, or a capital contribution to the partnership on or after December 18, 1992, unless the partnership agreement as in effect prior to December 18, 1992, requires the contribution; and

(ii) A principal purpose of the change in the terms of the partnership agreement or the capital contribution is to circumvent the limitation described in paragraph (c)(1) of this section.

(d) *Distributions to transferors and claimants.* Amounts that are distributed by a qualified settlement fund to, or on behalf of, a transferor or a claimant are not deductible by the fund.

(e) *Basis of property transferred to a qualified settlement fund.* A qualified settlement fund's initial basis in property it receives from a transferor (or from an insurer or other person on behalf of a transferor) is the fair market value of that property on the date of transfer to the fund.

(f) *Distribution of property.* A qualified settlement fund must treat a distribution of property as a sale or exchange of that property for purposes of section 1001(a). In computing gain or loss, the amount realized by the qualified settlement fund is the fair market value of

the property on the date of distribution.

(g) *Other taxes.* The tax imposed under paragraph (a) of this section is in lieu of any other taxation of the income of a qualified settlement fund under subtitle A of the Internal Revenue Code. Thus, a qualified settlement fund is not subject to the alternative minimum tax of section 55, the accumulated earnings tax of section 531, the personal holding company tax of section 541, or the maximum capital gains rate of section 1(h). A qualified settlement fund is, however, subject to taxes that are not imposed on the income of a taxpayer, such as the tax on transfers of property to foreign entities under section 1491.

(h) *Denial of credits against tax.* The tax imposed on the modified gross income of a qualified settlement fund under paragraph (a) of this section may not be reduced or offset by any credits against tax provided by part IV of subchapter A of chapter 1 of the Internal Revenue Code.

(i) [Reserved]

(j) *Taxable year and accounting method.* The taxable year of a qualified settlement fund is the calendar year. A qualified settlement fund must use an accrual method of accounting within the meaning of section 446(c).

(k) *Treatment as corporation for purposes of subtitle F.* Except as otherwise provided in § 1.468B-5(b), for purposes of subtitle F of the Internal Revenue Code, a qualified settlement fund is treated as a corporation and any tax imposed under paragraph (a) of this section is treated as a tax imposed by section 11. Subtitle F rules that apply to qualified settlement funds include, but are not limited to—

(1) A qualified settlement fund must file an income tax return with respect to the tax imposed under paragraph (a) of this section for each taxable year that the fund is in existence, whether or not the fund has gross income for that taxable year.

(2) A qualified settlement fund is in existence for the period that—

(i) Begins on the first date on which the fund is treated as a qualified settlement fund under § 1.468B-1; and

(ii) Ends on the earlier of the date the fund—

**Internal Revenue Service, Treasury**

**§ 1.468B-2**

(A) No longer satisfies the requirements of §1.468B-1; or

(B) No longer has any assets and will not receive any more transfers. (See paragraph (m) of this section for procedures for the prompt assessment of tax.)

(3) The income tax return of the qualified settlement fund must be filed on or before March 15 of the year following the close of the taxable year of the qualified settlement fund unless the fund is granted an extension of time for filing under section 6081. The return must be made by the administrator of the qualified settlement fund. The “administrator” (which may include a trustee if the qualified settlement fund is a trust) of a qualified settlement fund is, in order of priority—

(i) The person designated, or approved, by the governmental authority that ordered or approved the fund for purposes of §1.468B-1(c)(1);

(ii) The person designated in the escrow agreement, settlement agreement, or other similar agreement governing the fund;

(iii) The escrow agent, custodian, or other person in possession or control of the fund’s assets; or

(iv) The transferor or, if there are multiple transferors, all the transferors, unless an agreement signed by all the transferors designates a single transferor as the administrator.

(4) The administrator of a qualified settlement fund must obtain an employer identification number for the fund.

(5) A qualified settlement fund must deposit all payments of tax imposed under paragraph (a) of this section (including any payments of estimated tax) with an authorized government depository in accordance with §1.6302-1.

(6) A qualified settlement fund is subject to the addition to tax imposed by section 6655 in the case of an underpayment of estimated tax computed with respect to the tax imposed under paragraph (a) of this section. For purposes of section 6655(g)(2), a qualified settlement fund’s taxable income is its modified gross income and a transferor is not considered a predecessor of a qualified settlement fund.

(l) *Information reporting and withholding requirements*—(1) *Payments to a*

*qualified settlement fund.* Payments to a qualified settlement fund are treated as payments to a corporation for purposes of the information reporting requirements of part III of subchapter A of chapter 61 of the Internal Revenue Code.

(2) *Payments and distributions by a qualified settlement fund*—(i) *In general.* Payments and distributions by a qualified settlement fund are subject to the information reporting requirements of part III of subchapter A of chapter 61 of the Internal Revenue Code (Code), and the withholding requirements of subchapter A of chapter 3 of subtitle A and subtitle C of the Code.

(ii) *Special rules.* The following rules apply with respect to payments and distributions by a qualified settlement fund—

(A) A qualified settlement fund must make a return for, or must withhold tax on, a distribution to a claimant if one or more transferors would have been required to make a return or withhold tax had that transferor made the distribution directly to the claimant;

(B) For purposes of sections 6041(a) and 6041A, if a qualified settlement fund makes a payment or distribution to a transferor, the fund is deemed to make the payment or distribution to the transferor in the course of a trade or business;

(C) For purposes of sections 6041(a) and 6041A, if a qualified settlement fund makes a payment or distribution on behalf of a transferor or a claimant, the fund is deemed to make the payment or distribution to the recipient of that payment or distribution in the course of a trade or business;

(D) With respect to a distribution or payment described in paragraph (1)(2)(ii)(C) of this section and the information reporting requirements of part III of subchapter A of chapter 61 of the Internal Revenue Code, the qualified settlement fund is also deemed to have made the distribution or payment to the transferor or claimant.

(m) *Request for prompt assessment.* A qualified settlement fund is eligible to request the prompt assessment of tax under section 6501(d). For purposes of section 6501(d), a qualified settlement fund is treated as dissolving on the

date the fund no longer has any assets (other than a reasonable reserve for potential tax liabilities and related professional fees) and will not receive any more transfers.

(n) *Examples.* The following examples illustrate the rules of this section:

*Example 1.* On June 30, 1993, a United States federal district court approves the settlement of a lawsuit under which Corporation X must transfer \$10,833,000 to a qualified settlement fund on August 1, 1993. The \$10,833,000 includes \$10 million of damages incurred by plaintiffs on October 1, 1992, and \$833,000 of interest calculated at 10 percent annually from October 1, 1992, to August 1, 1993. The \$833,000 of interest is not a payment to the qualified settlement fund in compensation for a late or delayed transfer to the fund within the meaning of paragraph (b)(1) of this section because the payment of \$10,833,000 to the fund is not due until August 1, 1993.

*Example 2.* Assume the same facts as in *Example 1* except that the settlement agreement also provides for interest to accrue at a rate of 12 percent annually on any amount not transferred to the qualified settlement fund on August 1, 1993, and the only transfer Corporation X makes to the fund is \$11,374,650 on January 1, 1994. The additional payment of \$541,650 (\$11,374,650 paid on January 1, 1994, less \$10,833,000 due on August 1, 1993) is a payment to the qualified settlement fund in compensation for a late or delayed transfer to the fund within the meaning of paragraph (b)(1) of this section.

[T.D. 8459, 57 FR 60991, Dec. 23, 1992; 58 FR 7865, Feb. 10, 1993]

#### § 1.468B-3 Rules applicable to the transferor.

(a) *Transfer of property—(1) In general.* A transferor must treat a transfer of property to a qualified settlement fund as a sale or exchange of that property for purposes of section 1001(a). 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 (or is treated as made under § 1.468B-1(g)) 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). If a person other than the transferor transfers

property to a qualified settlement fund, there may be other tax consequences as determined under general federal income tax principles.

(2) *Anti-abuse rule.* The Commissioner may disallow a loss resulting from the transfer of property to a qualified settlement fund if the Commissioner determines that a principal purpose for the transfer was to claim the loss and—

(i) The transferor places significant restrictions on the fund's ability to use or dispose of the property; or

(ii) The property (or substantially similar property) is distributed to the transferor (or a related person).

(b) *Qualified appraisal requirement for transfers of certain property—(1) In general.* A transferor must obtain a qualified appraisal to support a loss or deduction it claims with respect to a transfer to a qualified settlement fund of the following types of property—

(i) Nonpublicly traded securities (as defined in § 1.170A-13(c)(7)(ix)) issued by the transferor (or a related person); and

(ii) Interests in the transferor (if the transferor is a partnership) and in a partnership in which the transferor (or a related person) is a direct or indirect partner.

(2) *Provision of copies.* The transferor must provide a copy of the qualified appraisal to the administrator of the qualified settlement fund no later than February 15 of the year following the calendar year in which the property is transferred. The transferor also must attach a copy of the qualified appraisal to (and as part of) its timely filed income tax return (including extensions) for the taxable year of the transferor in which the transfer is made.

(3) *Qualified appraisal.* A "qualified appraisal" is a written appraisal that—

(i) Is made within 60 days before or after the date the property is transferred to the qualified settlement fund;

(ii) Is prepared, signed, and dated by an individual who is a qualified appraiser within the meaning of § 1.170A-13(c)(5);

(iii) Includes the information required by paragraph (b)(4) of this section; and

(iv) Does not involve an appraisal fee of the type prohibited by § 1.170A-13(c)(6).