

§ 1.468B-0

26 CFR Ch. I (4-1-04 Edition)

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[T.D. 8459, 57 FR 60988, Dec. 23, 1992, as amended by T.D. 8495, 58 FR 58787, Nov. 4, 1993]

§ 1.468B-1 Qualified settlement funds.

- (a) *In general.* A qualified settlement fund is a fund, account, or trust that

satisfies the requirements of paragraph (c) of this section.

(b) *Coordination with other entity classifications.* If a fund, account, or trust that is a qualified settlement fund could be classified as a trust within the meaning of §301.7701-4 of this chapter, it is classified as a qualified settlement fund for all purposes of the Internal Revenue Code (Code). If a fund, account, or trust, organized as a trust under applicable state law, is a qualified settlement fund, and could be classified as either an association (within the meaning of §301.7701-2 of this chapter) or a partnership (within the meaning of §301.7701-3 of this chapter), it is classified as a qualified settlement fund for all purposes of the Code. If a fund, account, or trust, established for contested liabilities pursuant to §1.461-2(c)(1) is a qualified settlement fund, it is classified as a qualified settlement fund for all purposes of the Code.

(c) *Requirements.* A fund, account, or trust satisfies the requirements of this paragraph (c) if—

(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).

(d) *Definitions.* For purposes of this section—

(1) *Transferor.* A “transferor” is a person that transfers (or on behalf of whom an insurer or other person transfers) money or property to a qualified settlement fund to resolve or satisfy claims described in paragraph (c)(2) of this section against that person.

(2) *Related person.* A “related person” is any person who is related to the transferor within the meaning of sections 267(b) or 707(b)(1).

(e) *Governmental order or approval requirement—*(1) *In general.* A fund, account, or trust is “ordered by” or “approved by” a governmental authority described in paragraph (c)(1) of this section when the authority issues its initial or preliminary order to establish, or grants its initial or preliminary approval of, the fund, account, or trust, even if that order or approval may be subject to review or revision. Except as otherwise provided in paragraph (j)(2) of this section, the governmental authority’s order or approval has no retroactive effect and does not permit a fund, account, or trust to be a qualified settlement fund prior to the date the order is issued or the approval is granted.

(2) *Arbitration panels.* An arbitration award that orders the establishment of, or approves, a fund, account, or trust is an order or approval of a governmental authority described in paragraph (c)(1) of this section if—

(i) The arbitration award is judicially enforceable;

(ii) The arbitration award is issued pursuant to a bona fide arbitration proceeding in accordance with rules that are approved by a governmental authority described in paragraph (c)(1) of this section (such as self-regulatory organization-administered arbitration proceedings in the securities industry); and

(iii) The fund, account, or trust is subject to the continuing jurisdiction of the arbitration panel, the court of law that has jurisdiction to enforce the arbitration award, or the governmental authority that approved the rules of the arbitration proceeding.

(f) *Resolve or satisfy requirement—*(1) *Liabilities to provide services or property.*

Except as otherwise provided in paragraph (f)(2) of this section, a liability is not described in paragraph (c)(2) of this section if it is a liability for the provision of services or property, unless the transferor's obligation to provide services or property is extinguished by a transfer or transfers to the fund, account, or trust.

(2) *CERCLA liabilities.* A transferor's liability under CERCLA to provide services or property is described in paragraph (c)(2) of this section if following its transfer to a fund, account, or trust the transferor's only remaining liability to the Environmental Protection Agency (if any) is a remote, future obligation to provide services or property.

(g) *Excluded liabilities.* A liability is not described in paragraph (c)(2) of this section 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 that relates 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 (see § 601.601(d)(2)(ii)(b) of this chapter).

(h) *Segregation requirement—(1) In general.* If it is not a trust under applicable state law, a fund, account, or trust satisfies the requirements of paragraph (c)(3) of this section if its assets are physically segregated from other assets of the transferor (and related persons). For example, cash held by a transferor in a separate bank account satisfies the segregation requirement of paragraph (c)(3) of this section.

(2) *Classification of fund established to resolve or satisfy allowable and non-allowable claims.* If a fund, account, or trust is established to resolve or satisfy claims described in paragraph (c)(2) of this section as well as other types of claims (*i.e.*, non-allowable claims) arising from the same event or related series of events, the fund is a qualified settlement fund. However,

under § 1.468B-3(c), economic performance does not occur with respect to transfers to the qualified settlement fund for non-allowable claims.

(i) [Reserved]

(j) *Classification of fund prior to satisfaction of requirements in paragraph (c) of this section—(1) In general.* If a fund, account, or trust is established to resolve or satisfy claims described in paragraph (c)(2) of this section, the assets of the fund, account, or trust are treated as owned by the transferor of those assets until the fund, account, or trust also meets the requirements of paragraphs (c) (1) and (3) of this section. On the date the fund, account, or trust satisfies all the requirements of paragraph (c) of this section, the transferor is treated as transferring the assets to a qualified settlement fund.

(2) *Relation-back rule—(i) In general.* If a fund, account, or trust meets the requirements of paragraphs (c)(2) and (c)(3) of this section prior to the time it meets the requirements of paragraph (c)(1) of this section, the transferor and administrator (as defined in § 1.468B-2(k)(3)) may jointly elect (a relation-back election) to treat the fund, account, or trust as coming into existence as a qualified settlement fund on the later of the date the fund, account, or trust meets the requirements of paragraphs (c)(2) and (c)(3) of this section or January 1 of the calendar year in which all the requirements of paragraph (c) of this section are met. If a relation-back election is made, the assets held by the fund, account, or trust on the date the qualified settlement fund is treated as coming into existence are treated as transferred to the qualified settlement fund on that date.

(ii) *Relation-back election.* A relation-back election is made by attaching a copy of the election statement, signed by each transferor and the administrator, to (and as part of) the timely filed income tax return (including extensions) of the qualified settlement fund for the taxable year in which the fund is treated as coming into existence. A copy of the election statement must also be attached to (and as part of) the timely filed income tax return (including extensions), or an amended return that is consistent with the requirements of §§ 1.468B-1 through

1.468B-4, of each transferor for the taxable year of the transferor that includes the date on which the qualified settlement fund is treated as coming into existence. The election statement must contain—

(A) A legend, “§1.468B-1 Relation-Back Election”, at the top of the first page;

(B) Each transferor’s name, address, and taxpayer identification number;

(C) The qualified settlement fund’s name, address, and employer identification number;

(D) The date as of which the qualified settlement fund is treated as coming into existence; and

(E) A schedule describing each asset treated as transferred to the qualified settlement fund on the date the fund is treated as coming into existence. The schedule of assets does not have to identify the amount of cash or the property treated as transferred by a particular transferor. If the schedule does not identify the transferor of each asset, however, each transferor must include with the copy of the election statement that is attached to its income tax return (or amended return) a schedule describing each asset the transferor is treated as transferring to the qualified settlement fund.

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

Example 1. In a class action brought in a United States federal district court, the court holds that the defendant, Corporation X, violated certain securities laws and must pay damages in the amount of \$150 million. Pursuant to an order of the court, Corporation X transfers \$50 million in cash and transfers property with a fair market value of \$75 million to a state law trust. The trust will liquidate the property and distribute the cash proceeds to the plaintiffs in the class action. The trust is a qualified settlement fund because it was established pursuant to the order of a federal district court to resolve or satisfy claims against Corporation X for securities law violations that have occurred.

Example 2. (i) Assume the same facts as in *Example 1*, except that Corporation X and the class of plaintiffs reach an out-of-court settlement that requires Corporation X to establish and fund a state law trust before the settlement agreement is submitted to the court for approval.

(ii) The trust is not a qualified settlement fund because it neither is established pursuant to an order of, nor has it been approved

by, a governmental authority described in paragraph (c)(1) of this section.

Example 3. On June 1, 1994, Corporation Y establishes a fund to resolve or satisfy claims against it arising from the violation of certain securities laws. On that date, Corporation Y transfers \$10 million to a segregated account. On December 1, 1994, a federal district court approves the fund. Assuming Corporation Y and the administrator of the qualified settlement fund do not make a relation-back election, Corporation Y is treated as the owner of the \$10 million, and is taxable on any income earned on that money, from June 1 through November 30, 1994. The fund is a qualified settlement fund beginning on December 1, 1994.

Example 4. (i) On September 1, 1993, Corporation X, which has a taxable year ending on October 31, enters into a settlement agreement with a plaintiff class for asserted tort liabilities. Under the settlement agreement, Corporation X makes two \$50 million payments into a segregated fund, one on September 1, 1993, and one on October 1, 1993, to resolve or satisfy the tort liabilities. A federal district court approves the settlement agreement on November 1, 1993.

(ii) The administrator of the fund and Corporation X elect to treat the fund as a qualified settlement fund prior to governmental approval under the relation-back rule of paragraph (j)(2) of this section. The administrator must attach the relation-back election statement to the fund’s income tax return for calendar year 1993, and Corporation X must attach the election to its original or amended income tax return for its taxable year ending October 31, 1993.

(iii) Pursuant to the relation-back election, the fund begins its existence as a qualified settlement fund on September 1, 1993, and Corporation X is treated as transferring \$50 million to the qualified settlement fund on September 1, 1993, and \$50 million on October 1, 1993.

(iv) With respect to these transfers, Corporation X must provide the statement described in §1.468B-3(e) to the administrator of the qualified settlement fund by February 15, 1994, and must attach a copy of this statement to its original or amended income tax 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 ex-

penses 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