



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

OFFICE OF
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE CHIEF COUNSEL ADVICE

MEMORANDUM FOR CHIEF, PLANNING AND SPECIAL PROGRAMS, AREA 10
CHIEF, PLANNING AND SPECIAL PROGRAMS, AREA 14

FROM: Associate Chief Counsel (Income Tax & Accounting) /s/

SUBJECT: Settlement Fund

LEGEND

Escrow Agent =

Taxpayer =

State =

Company =

Consent Decree =

x =

y =

z =

Site =

Pursuant to section 8.07(2)(b) of Revenue Procedure 2001-1, 2001-1 I.R.B. 1, 91-92, we are writing to inform you that a taxpayer within your audit jurisdiction has withdrawn a request for a letter ruling.

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The private letter ruling was requested on behalf of Escrow Agent, as escrow agent of the proposed escrow account (Escrow Account) described below, and Taxpayer. Taxpayer requested a ruling regarding the tax consequences of settlement payments into the Escrow Account and the tax treatment of any income earned by the Escrow Account. We concluded that the Escrow Account would be a qualified settlement fund (QSF) under § 468B(g) of the Internal Revenue Code and any income earned by the Escrow Account would be includible in the Escrow Account's income (*i.e.*, the Escrow Account itself is a taxpayer). Upon informing the Escrow Agent and Taxpayer of our adverse position, they withdrew their request for a letter ruling.

FACTS

The United States Environmental Protection Agency (EPA) and State filed a complaint under the Comprehensive Environmental Response, Compensation and Liability Act (42 U.S.C. § 9601 *et. seq.*) (CERCLA) against Taxpayer to recover the costs associated with the remediation of the Site, which was originally owned by Company.

The EPA, State, Taxpayer and hundreds of other potentially responsible parties (PRPs) intend to enter into a consent decree designated as the Consent Decree. The Consent Decree is subject to court approval and all parties to the Consent Decree will submit to the court's jurisdiction to enforce the terms of the Consent Decree. The Consent Decree will establish the Escrow Account for receipt of cash settlement payments from Taxpayer and other PRPs. Pursuant to the Consent Decree, Taxpayer's payment of a specified amount to the Escrow Account will extinguish Taxpayer's liability under CERCLA.

The Escrow Account will be formed among Escrow Agent, and the parties to the Consent Decree. The Escrow Account will contain approximately \$x dollars. Escrow Agent will invest the settlement payments, and any earnings on the investments will be added to the corpus in the Escrow Account. The Escrow Account will terminate when the EPA has approved the remediation of the Site pursuant to the terms of the Consent Decree. Any funds remaining in the Escrow Account once the remediation is complete will be disbursed at the direction of EPA either for the benefit of the Site or as EPA may otherwise determine. Thus, no portion of the income or principal of the settlement payments will revert or be paid to Taxpayer.

LAW

Section 468B(g) provides that nothing in any provision of law will be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax.

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Section 1.468B-1(c) of the Income Tax Regulations provides, in part, that an account is a qualified settlement fund if (1) it is established pursuant to an order of, or is approved by, a court of law and is subject to the continuing jurisdiction of such 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 under CERCLA; and (3) the account's assets are segregated from other assets of the transferor (and related parties).

Taxpayer and Escrow Agent argued that the Escrow Account is not subject to § 468B(g) under various theories. We found their arguments to be unpersuasive and determined that upon court approval of the Consent Decree, the Escrow Account will constitute a qualified settlement fund under § 1.468B-1 because it will satisfy the three QSF requirements. First, the Escrow Account will be approved by a court and will be subject to that court's continuing jurisdiction. Second, the Escrow Account will be established to resolve at least one CERCLA claim against Taxpayer. Third, the Escrow Account funds will be segregated from other assets of Taxpayer.

Please note that the EPA and the State have also entered into y additional partial consent decrees involving the Site, and cash escrow accounts were created and maintained for z of these partial consent decrees. We do not have enough information to determine whether the other cash escrow accounts are QSFs. We bring the escrow accounts to your attention should your office wish to determine whether these escrow accounts are also QSFs, the income on which would ordinarily be subject to income tax under § 1.468B-2.

Please call Sara Shepherd at 622-4610 if you have any further questions.