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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-101392-24

Date:
July 24, 2024

Taxpayer	=	
Contributor	=	
Activities	=	
Product Z	=	
Plaintiffs	=	
Claims	=	
MSA	=	
Date 1	=	
Date 2	=	
Date 3	=	
X	=	
Escrow Agent Banks	=	
Number	=	

Dear :

This is in response to your ruling request on behalf of Taxpayer, joined by Contributor, dated December 28, 2023, and supplemented by correspondence dated May 14, 2024.

You requested the following rulings concerning the tax treatment of certain escrow accounts required by and established pursuant to law:

1. The escrow accounts administered by Taxpayer are qualified settlement funds within the meaning of § 1.468B-1 of the Income Tax Regulations; and

2. The contributions made by Contributor to the escrow accounts administered by Taxpayer are deductible for the taxable year in which they are made under §§ 162(a) and 461 of the Internal Revenue Code and § 1.468B-3.

FACTS

Taxpayer is funded by Contributor. Contributor is engaged in the Activities of Product Z. Contributor is an S corporation using an overall accrual method of accounting and has a taxable year ending December 31.

Various Plaintiffs brought litigation against major manufacturers and sellers of Product Z. The Plaintiffs sought various Claims. Contributor was not a party defendant in the suit.

On November 28, 1998, the Plaintiffs entered into a settlement agreement with the party defendant manufacturers to resolve the litigation. Under the settlement agreement, the party defendant manufacturers are required to make annual payments into escrow accounts for the benefit of the Plaintiffs. In exchange for the payments under the settlement agreement, the Plaintiffs release the party defendant manufacturers from all past, present and future claims arising from the Activities of Product Z. The amount of these payments is determined based on the party defendant manufacturers' sale of Product Z within the relevant jurisdiction. Under the settlement agreement, the escrow accounts established pursuant to the settlement agreement are intended to qualify and be treated as qualified settlement funds under § 1.468B-1.

The party defendant manufacturers contended, and the Plaintiffs agreed, that the manufacturers of Product Z not named in litigation should be required to make annual contributions similar to those required by the party defendant manufacturers under the settlement agreement. The settlement agreement directs the relevant jurisdiction to enact legislation requiring non-party manufacturers to either generally abide by the terms of the settlement agreement (*i.e.*, become a defendant manufacturer and perform financial obligations under the settlement agreement), or establish escrow accounts and make contributions for the benefit of the Plaintiffs in jurisdictions in which the non-party manufacturers' Product Z are sold. Contributor opted for the latter. Therefore, as a non-party manufacturer of Product Z selling Product Z within relevant jurisdictions, Contributor is required to establish escrow accounts under each Plaintiff's enacted legislation.

Each Plaintiff enacted the legislation mandated by the settlement agreement (enacted legislation). The enacted legislation is identical or substantially similar to a model statute attached to the settlement agreement. The model statute explains that financial burdens imposed by Product Z should be borne by Product Z's manufacturers rather than by the Plaintiffs to the extent that such manufacturers either determine to enter into a settlement with the Plaintiffs or are found culpable by the courts. The amount of the annual contribution due by the non-party manufacturers is determined based on the non-party manufacturer's sale of Product Z within the relevant jurisdiction.

Under the settlement agreement, the relevant jurisdictions are required to diligently enforce the provisions of their legislation to protect their claim to receive annual payments from the party defendant manufacturers. If the Plaintiffs fail to diligently enforce their legislations against a non-party manufacturer, the Plaintiffs can be subject to a downward adjustment of the Plaintiffs' entitled annual payment from the party defendant manufacturers, which is meant to offset a potential market loss as to the party defendant manufacturers caused by the Plaintiffs' failure to hold the non-party manufacturers to their escrow payment obligations.

The legislation enacted by the Plaintiffs requires each of the non-party manufacturers to establish and make annual contributions to an escrow account for the benefit of each of the Plaintiffs. The escrow accounts were established in Date 1 and Contributor began making annual deposits to the escrow accounts in Date 2. As of Date 3, Contributor has deposited a total of $X. As long as Contributor remains a Product Z's manufacturer selling Product Z within a relevant jurisdiction, it will continue to be required by enacted legislation to make annual deposits into such escrow accounts, based on its Product Z' sales, either at the Escrow Agent Banks, or similar financial institutions. Under the enacted legislation, the escrowed funds may be used only to satisfy claims arising from the manufacture and sale of Product Z by Contributor. The escrowed funds are released from escrow in the order in which they were placed into escrow and only to the extent and at the time necessary to make payments required under judgement or settlement. Under the enacted legislation, any remaining funds will revert to Contributor after Number years from the day they were contributed.

Under the enacted legislation, the relevant jurisdiction may use civil litigation to enforce the escrow contribution requirement. A court can require the non-party manufacturers to make the required contribution, can impose civil penalties up to 300% of the delinquent contributions, and can prohibit non-party manufacturers from selling Product Z to consumers within the relevant jurisdiction for a certain period.

Contributor expects that the Plaintiffs in which it does business will make claims against it, that all of the contributed funds will be used to satisfy the claims if the claims are successful, and nothing will remain to revert to Contributor.

RULINGS REQUESTED

1. The escrow accounts administered by Taxpayer are a qualified settlement fund within the meaning of § 1.468B-1.

2. The contributions made by Contributor to the escrow accounts administered by Taxpayer are deductible for the taxable year in which they are made under §§ 162(a), 461 and 1.468B-3.

LAW & ANALYSIS

1. The escrow accounts administered by Taxpayer are a qualified settlement fund within the meaning of § 1.468B-1.

Section 468B(g)(1) provides that "[n]othing 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." Section 468B(g)(1) authorizes the issuance of regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise. Sections 1.468B-1 through 1.468B-5 regarding qualified settlement funds were issued pursuant to § 468B(g).

Section 1.468B-1(a) provides that a qualified settlement fund is a fund, account, or trust that satisfies the three 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 continuing 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).

Section 1.468B-1(j)(1) provides that if a fund, account or trust is established to resolve or satisfy claims described in § 1.468B-1(c)(2), 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 § 1.468B-1(c)(1) and (c)(3). On the date the fund, account, or trust satisfies all the requirements of § 1.468B-1(c), the transferor is treated as transferring the assets to a qualified settlement fund.

Section 1.468B-2(k)(2) provides that 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 (A) no longer satisfies the requirements of § 1.468B-1; or (B) no longer has any assets and will not receive any more transfers.

Based on the facts represented, Taxpayer satisfied all three requirements of § 1.468B-1(c) in the year the escrow accounts were established, and therefore are treated as a qualified settlement fund as of the date established. First, with respect to § 1.468B-1(c)(1), the Plaintiffs are governmental authorities as the term is used in that context. The escrow accounts were established pursuant to the Plaintiffs' enacted legislation and are subject to the continuing jurisdiction of each of the relevant Plaintiffs. The appropriate official of the Plaintiffs has the authority to monitor and pursue in court charges against Taxpayer to enforce annual compliance with the Plaintiffs' enacted legislation.

Second, with respect to § 1.468B-1(c)(2), under all these facts and circumstances, we are persuaded that Taxpayer established the escrow accounts to resolve or satisfy contested or uncontested claims that have resulted or may result from a related series of events that has occurred and that has given rise to at least one claim asserting liability arising out of a violation of law.

The event (or related series of events) that has already occurred are the Activities of Product Z. The claim has already arisen that a manufacturer of Product Z is financially liable to reimburse the Plaintiffs for the costs associated with the harms related to the sale of Product Z. The regulation requires only that at least one “claim” asserting liability has resulted or may result. Each of the Plaintiffs has already made at least one claim asserting liability against each non-party manufacturer of Product Z by means of having an enacted legislation pursuant to the model statute and by means of making a demand for deposits against Contributor.

It is also clear that Taxpayer established and funded the escrow accounts to resolve or satisfy the claims (whether eventually contested or uncontested) and demands made by the Plaintiffs. The objective of the enacted legislation is to force non-party manufacturers who refuse to opt into the settlement agreement to assume a share of the financial burdens created by the harms allegedly caused by the use of Product Z. Each relevant jurisdiction has enacted legislation that applies to any non-party manufacturer of Product Z selling Product Z within the relevant jurisdiction. The amount of a manufacturer's annual deposits paid into the escrow accounts is based on a manufacturer's sales of Product Z during the year in question. Contributor is such a manufacturer and the amounts of its legally-obligated deposits are calculated on that basis.

Note that the facts in this case are distinguishable from Example 7 in § 1.468B-1(l) regarding a landfill operator. There, a corporation owned and operated a landfill in a state that required the corporation to transfer money to a trust annually based on the total tonnage of material placed in the landfill during the year. Under the law, the corporation is required to perform (either itself or through contractors) specified closure activities when the landfill is full, and the trust assets would be used to reimburse the corporation for these closure costs. The trust in that example is not a qualified settlement fund because it is established to secure the liability of the corporation to perform such closure activities. The instant case does not involve a performance liability. The funds transferred to the escrow accounts under the enacted legislation are not used to secure the future performance of Contributor. To the contrary, the funds will be used to satisfy the Plaintiffs' claims based on the past conduct of Contributor; conduct that is related to known harm stemming from the use of Product Z and that has given rise to known liabilities (*e.g.*, increase in financial burdens on the Plaintiffs).

Third, with respect to § 1.468B-1(c)(3), the assets in the escrow accounts are otherwise segregated from other assets of Taxpayer (and related persons). Beginning in Date 1, the escrow accounts were established with Escrow Agent Banks. Under the regulations, a separate bank account is sufficient to satisfy this requirement. *See* § 1.468B-1(h)(1).

2. The contributions made by Contributor to the escrow accounts administered by Taxpayer are deductible for the taxable year in which they are made under §§ 162(a), 461 and 1.468B-3.

Section 162(a) 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* § 1.162-1(a).

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

Section 1.461-1(a)(2) provides, in part, that under an accrual method of accounting, a liability is incurred, and generally 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(f) provides that if (1) the taxpayer contests an asserted liability, (2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability, (3) the contest with respect to the asserted liability exists after the time of the transfer, and (4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year) determined after application of § 461(h), then the deduction shall be allowed for the taxable year of the transfer.

Section 461(h)(1) provides, in part, that in determining whether an amount has been incurred with respect to any item during a taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such 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(c)(1) provides that for purposes of § 461(h), economic performance occurs with respect to a liability described in § 1.468B-1(c)(2) 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) provides that economic performance does not occur to the extent (A) the transferor (or a 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 (B) 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-3(f)(1) provides that a transferor must include in gross income any distribution it receives from a qualified settlement fund.

Section 1.468B-3(f)(3) provides that a distribution described in § 1.468B-3(f)(1) or (f)(2) is excluded from the gross income of a transferor to the extent provided by § 111(a) (regarding the recovery of tax benefit items).

Based on the facts represented, the contributions made by Contributor to the escrow accounts administered by Taxpayer are deductible in the taxable year of the transfer. The amounts transferred into escrow accounts will be used to pay money damages to the Plaintiffs for liabilities that arose as a result of Contributor's principal business activity, that is, the Activities of Product Z. Thus, such amounts are deductible under § 162(a) as ordinary and necessary business expenses. Further, Contributor may take the deduction for the amounts transferred into the escrow account in the year transferred because the all events test is met and economic performance occurs in that year under § 1.461-1(a)(2). The first prong of the all events test, *i.e.*, all the events have occurred that establish the fact of the liability, is met because this is a contested liability within the meaning of § 461(f). The second prong, *i.e.*, the amount of the liability can be determined with reasonable accuracy, is met because the amount of the liability can be readily ascertained based on the formula prescribed by the enacted legislation. Finally, under § 1.468B-3(c), transfers to a qualified settlement fund to resolve or satisfy claims for which it is established constitute economic performance.

In addition, the fact that the enacted legislation provides for a reversion of monies if any remain after Number years from the date of the transfers does not prevent economic performance from occurring. The enacted legislation provides that the monies transferred into the escrow accounts revert to Contributor after Number years from the date of the transfers if the Plaintiffs have not filed and prevailed on claims either by obtaining a judgment against, or a settlement with, Contributor. The funds exist to satisfy the Plaintiffs' claims brought against Contributor within Number years after the date monies are transferred into the funds. Thus, Contributor may not access the funds for any purpose other than satisfying the Plaintiffs' claims during the Number years. Contributor expects that claims will be made against all the assets of the funds and, if successful, the funds will be used to satisfy the Plaintiffs' claims and that nothing will remain to revert to Contributor. There is no guarantee that any amounts will revert to Contributor after Number years. The reversion in this case requires not only the passage of time, but also the successful defense against claims brought by the Plaintiffs before anything reverts to Contributor. Although the passage of time (*i.e.*, Number years) is certain to occur, it is clearly uncertain whether the Plaintiffs will file or prevail on claims against Contributor. Thus, the payments are not transferred under conditions that allow their refund or reversion by reason of the occurrence of an event that is certain to occur. Finally, Contributor does not have a currently exercisable right to a refund or reversion.

However, to the extent Contributor receives any distributions from the escrow accounts, *e.g.*, overpayments, refunds, interest, or other appreciation on the funds, Contributor must include such amounts in its gross income.

The ruling contained in this letter is based upon information and representations submitted by or on behalf of Taxpayer and accompanied by a penalty of perjury statement executed by an individual with authority to bind Taxpayer and Contributor and upon the understanding that there will be no material change in facts. While this office has not verified any of the material submitted in support of the request for this ruling, it is subject to verification on examination. The Associate office will revoke or modify a letter ruling and apply the revocation retroactively if there has been a misstatement or omission of controlling facts; the facts at the time of the transaction are materially different from the controlling facts on which the ruling was based; or, in the case of a transaction involving a continuing action or series of actions, the controlling facts change during the course of the transaction. *See* section 11.05 of Rev. Proc. 2024-1, 2024-1 I.R.B. 1, 65.

No opinion is expressed concerning the federal tax consequences under any Code provision other than the provisions specifically cited above. Except as expressly provided, 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 concerns only the federal income tax treatment of Taxpayer's and Contributor’s income and may not be cited or relied upon by any other taxpayer, including Taxpayer’s beneficiaries. We express no opinion whether Taxpayer or Contributor is appropriately taking into account under § 61 and § 1.468B-2 any income generated from the investment of the escrow accounts.

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.

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to each of Taxpayer's authorized representatives.

Sincerely,

ANNA W. GLEYSTEEN
Senior Technician Reviewer, Branch 6
Office of Associate Chief Counsel
(Income Tax & Accounting)

cc: