
REQUEST LETTER

07-005

05/22/2007

NAME
ADDRESS

Re: SEC v. 2ND NAME Settlement Fund, a Qualified Settlement Fund pursuant to Internal Revenue Code § 468B and the Treasury Regulations promulgated thereunder.

TIN: ##-#####

C/o NAME
ADDRESS

To Whom It May Concern:

The purpose of this letter is to request a ruling pursuant to Utah Code Ann. § 59-1-210 and Regulation § R861-1A-34. I have enclosed with this letter an executed Form TC-737, Power of Attorney, authorizing me to represent the above-referenced Taxpayer in this matter before the Utah State Tax Commission ("Commission").

STATEMENT OF FACTS

_____ The SEC v 2ND NQM3 Settlement fund ("Taxpayer" or "Requester") is a qualified settlement fund (QSF, as that term is defined in Internal Revenue Code ((IRC")) section 468B(g) and the Treasury Regulations ("Reg.") promulgated thereunder, section 1.468B-1 *et seq.*

The QSF Taxpayer was established after the United States Securities and Exchange Commission ("SEC") litigated an enforcement action against 2ND NAME, *et al.*, in the United States District Court for the District of Utah, Central Division (SEC v. 2ND NAME, et al., Case No. 2:02 CV-1086 (TC)). Pursuant to orders of the Court entering judgment, the defendants paid a total of \$259,068.62 in disgorgement, prejudgment interest and civil penalties. The funds were deposited into an interest-bearing money market account in which they earned interest. The funds were also used to purchase direct obligations of the U.S. government (i.e., Treasury bills) and earned interest thereon. For Federal income tax purposes, the earned interest is taxable pursuant to IRC section 468B(g) and the aforementioned Treasury Regulations. Accordingly, taxpayer has filed IRS Form 1120-SF reporting such income.

On June 2, 2005, the Court entered an Order To Appoint Tax Administrator (attached for your reference as Exhibit A) in which the Court approved the appointment of COMPANY to provide tax administrator services to the fund, including, but not limited to, filing applicable state tax returns and paying taxes reported thereon out of the Settlement Fund.

ISSUE STATEMENT

_____The Taxpayer requests the following rulings:

The QSF Taxpayer is or is not an entity subject to Utah Corporation Franchise or Income Tax, or *otherwise*.

The domicile of the QSF Taxpayer, irrespective of whether it is subject to Utah tax, is determined by reference to the location of the court-exercising jurisdiction over the QSF.

If the QSF Taxpayer is subject to Utah tax, any interest earned by the QSF on direct obligations of the United States government (e.g., Treasury interest) is subject to such tax and the QSF Taxpayer is permitted a credit against the tax as provided in U.C.A. 59-7-601(1).

STATEMENT OF LAW

_____The Taxpayer knows of no authorities on point with respect to Utah's taxation of qualified settlement funds, including any authorities contrary to the rulings requested below.

ANALYSIS

Ruling Request #1

_____A QSF is "a fund, account, or trust that satisfies" the three (3) conditions enumerated in Treas. Reg. § 1.468B-1©(1)-(3), which provides:

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

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 government authority;

It is established to resolve or satisfy one or more contested on 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 the Comprehensive Environment Response, Compensation and Liability Act of 1980 (hereinafter referred to as CERCLA), as amended, 42 U.S.C. 9601 et seq.; or
Arising out of a tort, breach of contract, or violation of law; or
Designated by the Commissioner in a revenue ruling or revenue procedure; and
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).

Treas. Reg. § 1.468B-2(a) provides: "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)."

Treas. Reg. 1.468B-2K provides: “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 tax imposed under paragraph (a) of this section is treated as a tax imposed section 11.”

Therefore, a QSF is treated as a corporation for purposes of procedure and administration (i.e., for purposes of Subtitle F) and the tax rate imposed on a QSF is that imposed on trusts and estates (i.e., under IRC § 1(e)), although such tax is treated as if imposed under IRC § 11 (i.e., tax imposed on corporations). Therefore, 3RD NAME conclusion that QSFs are “trusts or ...similar creatures” is not entirely accurate.

The Tax Administrator has made various general informal inquiries (attached for your reference as Exhibit B) to the Utah State Tax Commission (“Commission”) regarding Utah’s taxation of qualified settlement funds.¹ As a result, the Commission has, via completion of questionnaires submitted to the Commission by the Tax Administrator, in general, opined that QSFs are taxable entities.

In a reply dated January 12, 1995, Chairman W. Val Oveson opined as follows:

¹These prior inquiries were not related to a specific taxpayer, including the instant Taxpayer.

The Utah statute does not have any specific language addressing Settlement Funds as defined in IRC 468B. However, U.C.A. 59-7-101(8) defined corporation to included entities defined as corporations under Sections 7701(a) and 7704, Internal Revenue Code. Internal Revenue Code Section 468N(b)(5) states that for purposes of Subtitle F [Procedure and Administration], a designated settlement fund² shall be treated as a corporation and, any tax imposed by this subsection shall be treated as a tax imposed by [IRC] Section 11 [Tax On corporations].

Because, the Utah definition of “corporation” ties to the federal definition and because Settlement Funds are taxed as corporations for federal purposes, Utah will also tax the settlement fund as a corporation. Of course, the settlement fund would only be taxable for Utah corporation franchise tax purposes if it is located in Utah or otherwise has Utah connections.

Consequently, Taxpayer believes that QSFs are, in general, taxable as corporations for purposes of Utah taxation.

Ruling Request #2

_____As noted above, Mr. Oveson states that a “settlement fund would only be taxable for Utah corporation franchise tax purposes if it is located in Utah or otherwise has Utah connections.” However, Mr. Oveson does not state when a QSF is “located in Utah” or “has Utah connections.”

In a reply to the Tax Administrator's inquiry of November 23, 1998 regarding Utah's criteria for determining the domicile of a QSF, the Commission wrote that a qualifies settlement fund is domiciled in Utah and subject to Utah Tax if:

[t]he capital establishing the settlement fund results from an activity that took place in Utah. An example would be a lawsuit resulting from an injury that occurred in Utah. Typically, an action filed in a Utah court would result from an activity that took place in Utah.

Consequently, Taxpayer believes it is domiciled in Utah because the court exercising jurisdiction over the QSF is located in Utah.

² Although Mr. Oveson's reply is with respect to "designated settlement funds" (DSFs), as defined in IRC § 468B(d)(2), not "qualified settlement funds," as defined in IRC § 468B(g) and Treas. Reg. § 1.468B-1, the Taxpayer believes that DSFs and QSFs are substantially similar so as to warrant the application of Mr. Oveson's analysis to QSFs.

Ruling Request #3

_____ U.C.A. 59-7-601(1) provides, "There shall be allowed as a credit against the tax an amount equal to 1% of the gross interest income included in state taxable income from: ... (b) stock, notes, or obligations issued by, or guaranteed by the United States Government, or any of its agencies and instrumentalities as defined under federal law."

PROCEDURAL REQUIREMENTS

_____ Pursuant to Regulation § R861-1A-34.A.2, to the best knowledge of the Taxpayer, this matter is not pending before the commission in an audit assessment, refund request, or other agency action or regarding matters that are pending before the court on judicial review of a commission decision.

Thank you for your assistance in this matter. Should you have any questions or require additional information, please feel free to contact me.

Sincerely,
NAME
ADDRESS

Enclosures

RESPONSE LETTER – 07-005

January 9, 2008

NAME
ADDRESS

Re: Private Letter Ruling Request 07-005
Treatment of Qualified Settlement Funds

Dear NAME:

We have received your letter requesting a ruling regarding the tax treatment of Qualified Settlement Funds (QSFs). You represented that a U.S. Securities & Exchange Commission enforcement action brought in the District Court of Utah, Central Division (SEC v. 2ND NAME et. al.), resulted in a total judgment of \$###,###.##, which has been deposited into an interest bearing account, composed of Treasury bills. That account is a QSF as defined in Section 468B of the Internal Revenue Code (IRC) and the regulations promulgated thereunder. NAME has been appointed as the Tax Administrator of that fund.

You have asked three questions concerning the QSF: first, whether the QSF described in your letter is subject to Utah Corporation Franchise or Income Tax; second, whether the QSF, irrespective of question one, is domiciled in the state of the court exercising jurisdiction over the QSF; and third, if the QSF is subject to Utah tax, is it eligible for the tax credit provided in Utah Code Ann. §59-7-601(1) for interest earned on the Treasury bills.

Regarding the first question, a Utah-based QSF would be subject to the Utah corporate franchise tax since it is taxed as a corporation for Federal purposes. §59-7-101(8) defines corporations for franchise tax purposes as: (a) entities defined as corporations under Sections 7701(a) and 7704 of the Internal Revenue Code (IRC); (b) other organizations that are taxed as corporations for federal income tax purposes under the IRC. Since a QSF is taxed as a corporation under the IRC, it is also taxed as a corporation for Utah purposes.

As an aside, although you did not ask this specific question, we point out federal net operating loss carryovers are not deductible from Utah taxable income. Rather Utah has its own provisions, which should be followed should this situation arise.

The second question concerns the domicile of the QSF. Since the legal action occurred in the Utah District Court, the Commission believes that the QSF is subject to Utah tax because of the controlling jurisdiction of the Utah Court, and the associated connections in the State of Utah.

The third question asks whether the QSF may claim a tax credit under §59-7-601 equal to 1% of the income received on Treasury bills or other obligations of the U.S. government or its agencies and instrumentalities. This credit, as you described, is available to any taxpayer taxed as a corporation, including this QSF, to the extent

prescribed in statute.

This conclusion is based on the information provided to us. Our response could be different if the facts are other than those upon which these responses are based. Should you have further questions, please contact us.

For the Commission,

Marc B. Johnson, Commissioner

MBJ/HW