
Opinion of the Tax Commissioner

Date Issued: September 21, 2000

Opinion No: 99-0004

Tax: Corporate Franchise/
Personal IncomeXXXX
XXXX
XXXX

Subject: Qualified Settlement Fund

This request for an opinion of the Tax Commissioner was received on October 5, 1999 XXXX (hereinafter referred to as either the “Trilateral Settlement Trust” or simply the “Trust”) represents itself to be a “qualified settlement fund” under section 1.468B-1 of the Treasury Regulations issued pursuant to Section 468B(g) of the Internal Revenue Code of 1986, as amended. As such, the trust does not feel it is subject to the following taxes:

1. the Ohio corporate franchise tax imposed by R.C. 5733.06 including any filing or reporting obligations with respect thereto if, as alleged, the Trust is not an association taxable as a corporation for federal income tax purposes;
2. the tax imposed on individuals and estates under R.C. Chapter 5747, nor subject to the pass-through entity withholding requirements of R.C. 5747.41 for “qualifying trusts”; and
3. the tax as a dealer in intangibles as that term is defined in R.C. 5725.01(B).

Background Information

Prior to 1972, COMPANY A produced certain MATERIAL-containing products. Since that time COMPANY A has had thousands of MATERIAL related claims filed against it and expects that thousands of other claims will be asserted in the future.

For a number of years, COMPANY A has been engaged in extended litigation (1) defending against the MATERIAL claims lodged against it and (2) attempting to establish coverage by and recover sums from various insurers allegedly responsible for indemnifying COMPANY A for the MATERIAL claims made against the company.

On DATE, COMPANY A entered into a settlement with the following insurers: COMPANY B, COMPANY C, COMPANY D and COMPANY E (the “Insurers”). This settlement, which is referred to as the “Trilateral Settlement”, resolves COMPANY A's claims for MATERIAL coverage against the Insurers. The Trilateral Settlement does not, however, resolve COMPANY A's obligations to the MATERIAL claimants.

On DATE, COMPANY A and the Insurers entered into a settlement with the representatives of the plaintiff class and the representatives of a third party class (mainly

codefendants) to resolve fully and finally the claims of the classes against both COMPANY A and the Insurers. This latter settlement is referred to as the "Global Settlement".

Each of the referenced settlements required court approval and each called for the establishment of a settlement trust. The XXXX Court (the "Court") has presided over a class action suit against COMPANY A on behalf of a defined class of individuals who have or in the future may have MATERIAL-related claims against COMPANY A. In MONTH-YEAR, the Court approved both of the referenced settlements. In MONTH-YEAR, the SECOND Court affirmed the Court's judgment.

Approval of the Global Settlement, however, was appealed to the THIRD Court. In YEAR, the THIRD Court vacated the SECOND Court's affirmation of the Global Settlement. The SECOND COURT once again affirmed the Global Settlement, and the case again went to the THIRD Court. In MONTH-YEAR, the THIRD Court again reversed the decision of the SECOND Court, in effect disapproving finally the Global Settlement Agreement. As a result, the Global Settlement Trust will not be funded, but the Trilateral Settlement Trust will be funded.

As part of the settlements, the Insurers established an escrow fund (the "COMPANY A Fund") pursuant to an escrow agreement between the Insurers and XXXX Bank OUTSIDE OHIO, as escrow agent. The balance in the COMPANY A Fund will be transferred to the Trilateral Settlement Trust. The Trilateral Settlement Trust will use the funds to make payments to plaintiffs in settlement or satisfaction of their claims against COMPANY A, or to COMPANY A as reimbursement of its payments to plaintiffs, as well as for claim processing and defense costs.

Relevant Provisions of the Trilateral Settlement Agreement

As prescribed in Article 2.1 of the Trilateral Settlement Agreement dated DATE, between COMPANY A and the Insurers, the Insurers have paid \$XXXX plus interest into the COMPANY A Fund, which presently has a balance of approximately \$XXXX. The Global Settlement Agreement having been disapproved and the Trilateral Settlement Agreement having been approved, the amount in the COMPANY A Fund will be transferred to the Trilateral Settlement Trust, along with additional amounts the Insurers will pay in accordance with section 2.3 of the Trilateral Settlement Agreement.

Relevant Provisions of the Trilateral Trust Agreement

The Trilateral Trust was established in accordance with Article 2.3(c) of the Trilateral Settlement Agreement pursuant to a Trust Agreement dated DATE.

The Trustees have the Fiduciary powers and responsibilities prescribed in Article 5 of the Trilateral Trust Agreement. In particular, the Trustees are authorized to operate and administer a Claims Resolution Facility (as defined therein) for processing, administering, liquidating, and resolving MATERIAL-related claims.

Consistent with the foregoing, section 3.1 of the Trilateral Trust Agreement provides that the Trustees will be required to use the Trust assets to pay MATERIAL-related claims against COMPANY A, as well as the Trust's expenses, in accordance with the terms, conditions, and limitations of section 2.3 of the Trilateral Settlement Agreement.

Section 5.3 of the Trilateral Trust Agreement provides the Trustees "shall exercise the judgment and care, under the circumstances then prevailing, which persons of prudence, discretion, and intelligence exercise in the management of their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds." In this regard, the Trustees' function is to conserve and protect trust assets. The Trilateral Settlement Trust will not engage in a commercial activity.

Section 3.1 of the Trilateral Trust Agreement also provides that the Trilateral Settlement Trust will terminate on the earlier of DATE, or thirty days after COMPANY A shall have submitted to the Trustees written notice that it will claim no other amounts from the Trustees. The Trustees shall then pay all remaining claims, or establish reasonable reserves for them, and shall distribute the remaining Trust Estate to one or more organizations described in Section 170(c) of the Internal Revenue Code of 1986 (or such comparable successor provisions of the United States income tax laws then in effect) that are primarily engaged in conducting medical research or providing medical care for MATERIAL-related or other XXXX diseases.

Other Relevant Facts

No person or entity currently holds, or will hold in the future, a transferable beneficial interest in the Trilateral Settlement Trust. Accordingly, the Trust would not constitute a business trust. See R.C. 1746.01(A).

The Trilateral Settlement Trust will have its principal office and most of its employees, including its executive offices, located in the State of Ohio.

The principal activity of the Trilateral Settlement Trust will be administering Trust distributions, including receiving claims, logging and tracking them, evaluating alleged injuries and damages requested, arbitrating or litigating disputed claims, and paying claims.

The Trilateral Settlement Trust does not now, nor will it in the future, maintain an office or other place of business within the State of Ohio from which it will engage in the business of lending money or discounting, buying or selling bills of exchange, drafts, acceptances, notes, mortgages, or other evidences of indebtedness, or of buying or selling bonds, stocks or other investment securities, whether on its own account with a view to profit, or as agent or broker for others, with a view to profit or personal earnings. The Trilateral Settlement Trust will protect and preserve its assets by engaging in the investment activity permitted under Section 4.3 of the Trilateral Trust Agreement from an office in Ohio. In this regard, the Trilateral Settlement Trust will engage the services of independent investment advisors and other professionals, some of which may be located in Ohio.

The Trilateral Settlement Trust will accomplish some or all of its investment and Trust Distributions, as well as its claims administration functions with its own employees, independent professionals, and/or independent contractors.

The Trilateral Settlement Trust is not subject to subchapter J of the Internal Revenue Code, nor will it have any income or gain from tangible personal property or real property in Ohio.

IRS Ruling on the Trilateral Settlement

In response to a ruling request, it is alleged that the Internal Revenue Service (“I.R.S.”), on DATE, issued several rulings regarding the federal income tax consequences associated with the funding and operation of the Trilateral Settlement Trust. In particular, the I.R.S. ruled:

- The Trilateral Settlement Trust will constitute a qualified settlement fund under Treas. Reg. § 1.468B-1.
- COMPANY A will not recognize any taxable income by reason of the transfer to the Trilateral Settlement Trust of the balance in the COMPANY A Fund.
- Neither COMPANY A nor the Insurers will be taxable on the income of the Trilateral Settlement Trust. Pursuant to I.R.C. § 468B(g) and the regulations thereunder, the Trilateral Settlement Trust is subject to the tax imposed under I.R.C. § 1(e) (i.e. as imposed on trusts and estates) on its modified gross income, which will not include either the amount transferred from the escrow fund or the money transferred by COMPANY A. However, the Trilateral Settlement Trust’s modified gross income will include the payments, if any, made in compensation for late or delayed transfers to the trilateral Settlement Trust.

Analysis of Law Relating to Opinion I

Pursuant to R.C. 5733 .01:

A corporation is subject to the tax imposed by [Chapter 5733 of the Ohio Revised Code] for each calendar year that it is * * * organized [in Ohio], doing business [in Ohio], owning or using a part or all of its capital or property [in Ohio], or holding a certificate of compliance [issued by the Secretary of State of Ohio] on the first of January of that calendar year. (Bracketed matter added.)

Pursuant to R.C. 5733.01(E):

Any person, as defined in section 5701.01 of the Revised Code, shall be treated as a corporation for purposes of this chapter if the person is classified for federal income tax purposes as an association taxable as a corporation.

The Trilateral Settlement Trust has not been formed as a corporation under the laws of any State. See also Prop. Treas. Reg. §§ 301.7701-2 and 301.7701-3.¹ Importantly, the Trilateral Settlement Trust has represented that it is not a business trust or other association taxed as a corporation for federal income tax purposes as required by R.C. 5733.01(E). So long as the Trust is not subject to federal income taxation as a corporation, the Trilateral Settlement Trust will not be required to file any report or return under R.C. Chapter 5733.

Analysis of Law Relating to Opinion 2

Income Tax

R.C. 5747.02(A) provides:

For the purpose of providing revenue for the support of schools and local government functions, to provide relief to property taxpayers, to provide revenue for the general revenue fund, and to meet the expenses of administering the tax levied by this chapter, there is hereby levied on every individual and every estate residing in or earning or receiving income in this state * * * an annual tax measured in the case of individuals by adjusted gross income less an exemption for the taxpayer, the taxpayer's spouse, and each dependent as provided in section 5747.025 of the Revised Code, and measured in the case of estates by taxable income.

The Trilateral Settlement Trust is neither an individual nor an estate. Accordingly, the Trilateral Settlement Trust will not be subject to the income tax imposed on individuals and estates under R.C. Chapter 5747.

Pass-Through Entity Tax

R.C. 5733.40(M) provides in pertinent part:

“Qualifying trust” means a trust subject to subchapter J of the Internal Revenue Code that, during any portion of the trust's qualifying taxable year, has income or gain from the acquisition, management, ownership, use, or disposition of tangible personal property located in this state at any time during the trust's qualifying taxable year or real property located in this state. ***

¹ It is noted that the I.R.S. has ruled that the Trilateral Settlement Trust constitutes a qualified settlement fund for federal income tax purposes.

R.C. 5747.41 levies: “a “withholding tax on every *** qualifying trust having at least one qualifying beneficiary who is an individual.”

If, as alleged, the Trilateral Settlement Trust is not subject to subchapter J of the Internal Revenue Code and if, as asserted, it will not have any income or gain from tangible personal property or real property located in this state, it will not be a “qualifying trust” as defined in R.C. 5733.40(M). Moreover, R.C. 5733.40(I)(9)(b) exempts from withholding all beneficiaries of this type of trust. Accordingly, for these reasons it will not be subject to the pass-through entity withholding requirements of R.C. 5747.41.

Analysis of Law Relating to Opinion 3[*]

R.C. 5725.01(B) defines the term “dealer in intangibles” as:

Every person who keeps an office or other place of business in this state and engages at such office or other place in the business of lending money, or discounting, buying or selling bills of exchange, drafts, acceptances, notes, mortgages, or other evidences of indebtedness, or of buying or selling bonds, stocks, or other investment securities, whether on its own account with a view to profit, or as agent or broker for others, with a view to profit or personal earnings.

Based on the facts set forth in the Trilateral Settlement Trust’s opinion request, the Trust will not be subject to tax as a dealer in intangibles. Its principal business activity does not include those enumerated in R.C. 5725.01(B). See *Stephens v. Glander* (1949), 151 Ohio St. 62.

Conclusion

The Trilateral Settlement Trust, from the facts it has presented, is not subject to (1) Ohio’s corporate franchise tax, (2) Ohio’s income or pass-through entity withholding tax or (3) Ohio dealer in intangibles tax [*]. This opinion is limited to these taxes and does not apply to any others such as the withholding tax on employees under R.C. 5747.06.

The tax consequences stated in this opinion may be subject to change for any of the reasons stated in R.C. 5703.53(C). It is the duty of the Trilateral Settlement Trust to be aware of such changes. R.C. 5703.53(E).

Thomas M. Zaino
Tax Commissioner

[* NOTE Opinion 3 is informational because the dealer in intangibles tax is not subject to a formal opinion request.]