
Opinion of the Tax Commissioner

Date Issued: May 6, 2008

Opinion No: 08-0003

Tax: Corporate Franchise/Personal Income

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Subject: Qualified Settlement Fund

XXXX (the "Fund"), through its attorney, XXXX, 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 ("IRC"). As such, the Fund requests an Opinion of the Tax Commissioner ("Opinion" that the Fund is not subject to the following taxes:

1. The Ohio corporate franchise tax imposed by Ohio Revised Code section ("R.C.") 5733.06 including any filing or reporting obligations with respect thereto if the Fund is not an association taxable as a corporation for federal income tax purposes;
2. The tax imposed on individuals, estates, and trusts 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

The Fund is a qualified settlement fund ("QSF"), as that term is defined in IRC section 468B(g) and the Treasury Regulations ("Reg.") promulgated thereunder, section 1.468B-1 *et seq.*

The Fund was established after the United States Securities and Exchange Commission ("SEC") litigated an enforcement action against XXXX (XXXX, Case No. NNNN) in the United States District Court for the XXXX District XXXX. Pursuant to an Order of the Court entering final judgment against the defendant, the defendant was required to disgorge \$NNNN, as well as prejudgment interest thereon in the amount of \$NNNN. Defendant was also required to pay a civil penalty in the amount of \$NNNN. The funds were deposited into an interest-bearing account with the Court Registry Investment System ("CRIS") of the above-referenced court. The interest thereon is taxable under the aforementioned section of the IRC and Treasury Regulations.

Analysis of Law Relating to Opinion 1

Corporation Franchise Tax

R.C. 5733 .01 provides, in part, as follows:

A corporation is subject to the tax imposed by [R.C. Chapter 5733] 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.)

R.C. 5733.01(E) provides, in part, as follows:

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 Fund 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. Importantly, the Fund has represented that it is not a business trust or other association taxed as a corporation for federal income tax purposes so it is not treated as a corporation for purposes of the Ohio franchise tax under the terms of R.C. 5733.01(E). A QSF is treated as a corporation and any tax imposed on a QSF is treated as a tax imposed by section 11 of the Internal Revenue Code, but only for purposes of subtitle F of the Internal Revenue Code (dealing with procedure and administration). *See* Reg. § 1.468B-2(k). A QSF is subject to tax at a rate equal to the maximum rate in effect for that taxable year under section 1(e) (tax imposed on estates and trusts). *See* Reg. § 1.468B-2(a). Furthermore, if a fund, account or trust that is a QSF could be classified as a trust within the meaning of Treas. Reg. § 301.7701-4, or is organized as a trust under applicable state law and could be classified as either an association (within the meaning of Treas. Reg. § 301.7701-2) or a partnership (within the meaning of Treas. Reg. 301.7701-3), that fund is classified as a QSF for all purposes of the Internal Revenue Code. *See* Reg. § 1.468B-1(b). Therefore, because the Fund is not subject to federal income taxation as a corporation, the Fund 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(E) provides as follows:

For the purposes of this section, “trust” means any trust described in Subchapter J of Chapter 1 of the Internal Revenue Code, excluding trusts that are not irrevocable as defined in division (I)(3)(b) of section 5747.01 of the Revised Code and that have no modified Ohio taxable income for the taxable year, charitable remainder trusts, qualified funeral trusts, and pre-need funeral contract trusts established pursuant to section 1111.19 of the Revised Code that are not qualified funeral trusts, endowment and perpetual care trusts, qualified settlement trusts and funds, designated settlement trusts and funds, and trusts exempted from taxation under section 501(a) of the Internal Revenue Code.

If the Fund is, in fact, a qualified settlement fund, then the Fund will not be subject to the income tax imposed on individuals, estates, and trusts under R.C. Chapter 5747.

Pass-Through Entity Tax

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

“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. ***

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

If the Fund is not subject to subchapter J of the Internal Revenue Code and if the Fund will not have any income or gain from tangible personal property or real property located in this state, the Fund 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 the Fund will not be subject to the pass-through entity withholding requirements of R.C. 5747.41.

Analysis of Law Relating to Opinion 3 [*]

Dealer in intangibles Tax

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

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 Fund’s opinion request, the Fund will not be subject to tax as a dealer in intangibles. The Fund's principal business activity does not include any of those enumerated in R.C. 5725.01(B). See *Stephens v. Glander* (1949), 151 Ohio St. 62.

Conclusion

The Fund, 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's dealer in intangibles tax [*]. This opinion is limited to these taxes and does not apply to any other taxes such as the withholding tax on employers under R.C. 5747.06.

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

Richard A. Levin
Tax Commissioner

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