
Opinion of the Tax Commissioner

Date Issued: March 21, 1997

Opinion No: 97-0001

Tax: Corporate Franchise/
Personal IncomeXXXX
XXXX
XXXX

Subject: Qualified Settlement Fund

This request for an opinion of the Tax Commissioner was received on January 13, 1997. For the reasons set forth below, it is the opinion of the Tax Commissioner that the XXXX Compensation Trust (hereinafter referred to as either the "Global Settlement Trust" or simply the "Trust"), which you have represented 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:

1. will not be subject to the tax imposed on corporations, and business trusts treated as corporations, under R.C. Chapter 5733 and for that reason will not be required to file any report or return under such chapter.
2. will not be subject to the tax imposed on individuals and estates under R.C. Chapter 5747.
3. will not be subject to 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 co-

defendants) 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 requires court approval and each calls 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. After all appeals are exhausted, if the Global Settlement is ultimately approved, the Global Settlement Trust will be funded.¹ The Global Settlement Trust would then make payments directly to plaintiffs for their claims and would also pay for claim processing and defense costs.

As part of the proposed settlements, the Insurers have 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 of the COMPANY A Fund will be transferred to either the Global Settlement Trust or the Trilateral Settlement Trust, depending upon which of the trusts is to be funded. In the event that neither the Global Settlement nor the Trilateral Settlement is approved and thus neither of the trusts is to be funded, the COMPANY A Fund will be returned to the Insurers.

Relevant Provisions of the Global Settlement Agreement

As prescribed in Article 2 of the settlement agreement dated as of DATE, between COMPANY A, the Insurers and representatives of the settlement class (the "Global Settlement Agreement"), the Insurers have paid \$XXXX into the COMPANY A Fund. Upon court approval of the Global Settlement, the amount in the COMPANY A Fund will be transferred to the Global Settlement Trust. In addition, COMPANY A will pay \$XXXX into the Global Settlement Trust, plus simple interest at XXXX% from DATE. COMPANY A's obligation for substantially all of the interest element may be satisfied by an assignment of its rights to interest and other damages from XXXX Insurance Company.

Section 5.1 of the Global Settlement Agreement prescribes that the Global Settlement Trust shall be created in accordance with the COMPANY A MATERIAL Compensation Trust Agreement (the "Global Trust Agreement"), which is attached as Exhibit B to the Global Settlement Agreement. Section 5.1 of the Global Settlement Agreement further provides that the Global Settlement Trust "shall be separate and independent from COMPANY A." Section 5.2 of the Global Settlement Agreement provides that the Court "shall retain continuing jurisdiction over the maintenance, administration and distribution of the Trust and the funds contained therein."

Relevant Provisions of the Global Trust Agreement

¹ If the Global Settlement is approved, the "Trilateral Settlement Trust," resulting from the Trilateral Settlement, will not be funded.

Section 2.2 of the Global Trust Agreement provides that the purposes of the Global Settlement Trust are (1) to use the Trust estate to efficiently deliver fair and equitable compensation to all qualified claimants consistent with Trust resources, (2) to enhance and preserve the Trust estate, and (3) to carry out the provisions of the Trust Agreement and the Trust Distribution Process, as defined.

The Trustees will have the fiduciary powers and responsibilities prescribed in Article 3 of the Global Trust Agreement. In particular, the Trustees will be 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 4.2 of the Global Trust Agreement provides that the Trustees will be required to use the Trust's assets to pay MATERIAL-related claims against COMPANY A, as well as the Trust's expenses.

Section 4.3 of the Global Trust Agreement permits the Trustees generally to invest the trust *res* in publicly traded, high-grade (i.e., a rating of A+ by Standard & Poors Corporation) securities, high-grade debt instruments, certificates of deposits issued by relatively risk-free banks, or other similar low-risk items. In this regard, the Trustees' function is to conserve and protect trust assets. The Global Settlement Trust will not engage in a commercial activity.

Section 7.2 of the Global Trust Agreement provides that the Global Settlement Trust will terminate when all MATERIAL-related claims payable from the Trust have been resolved or upon approval of the Court when no claims have been filed with the Trust for twenty-four (24) months. Upon termination of the trust, the remaining trust estate will be distributed for such charitable purposes as the Trustees shall determine.

Other Relevant Facts

No person or entity currently holds, or will hold in the future, a transferable beneficial interest in the Global Settlement Trust.

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

The principal activity of the Global 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 Global 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 leading 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 Global Settlement Trust will protect and preserve its assets by engaging in the investment activity permitted under Section 4.3 of the

Global Trust Agreement from an office in Ohio. In this regard, the Global Settlement Trust will engage the services of independent investment advisors and other professionals, some of whom may be located in Ohio.

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

IRS Ruling on the Global Settlement

In response to a ruling request filed on DATE, 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 Global Settlement Trust. In particular, the I.R.S. ruled:

* The Global 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 Global Settlement Trust of the balance in the COMPANY A Fund.

* Neither COMPANY A nor the Insurers will be taxable on the income of the Global Settlement Trust. Pursuant to I.R.C. § 468B(g) and the regulations thereunder, the Global Settlement Trust is subject to tax 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 Global Settlement Trust's modified gross income will include the payments, if any, made in compensation for late or delayed transfers to the Global Settlement Trust.

Analysis of Law Relating to Opinion I

Pursuant to R.C. § 5733.01(B):

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. (Emphasis and bracketed matter added.)

Pursuant to R.C. § 5733.01(E):

A business trust as defined in division (A) of section 1746.01 of the Revised Code shall be treated as a corporation organized for profit for purposes of this chapter. (Emphasis added.)

The Global Settlement Trust has not been formed as a corporation under the laws of any State and is not a corporation for Ohio franchise tax purposes. See also Prop. Treas. Reg. §§ 301.7701-2 and 301.7701-3.²

Turning to whether the Global Settlement Trust qualifies as a business trust, which may be treated as a corporation for Ohio franchise tax purposes, R.C. § 1746.01(A) defines the term business trust as:

[A]n unincorporated business association which is created by a trust instrument, pursuant to common law or enabling legislation, under which property is held, managed, administered, controlled, invested, reinvested, and operated, or under which business or professional activities, as permitted by the laws governing any profession, for profit are carried on by a trustee or trustees for the benefit and profit of such person or persons as are or may become the holders of transferable shares of beneficial interest in the trust estate.

By definition, a business trust must have holders of transferable shares of beneficial interest. The Global Settlement Trust agreement makes no provision for such interests. Accordingly, it is not a business trust and will not be subject to the tax imposed on corporations under R.C. Chapter 5733. For that reason, the Global Settlement Trust will not be required to file any report or return under such chapter.

Analysis of Law Relating to Opinion 2

R.C. § 5747.02(E) 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, a 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 Global Settlement Trust is neither an individual nor an estate. Accordingly, the Global Settlement Trust will not be subject to the tax imposed on individuals and estates under R.C. Chapter 5747.

² It is noted that the I.R.S. has ruled that the Global Settlement Trust constitutes a qualified settlement fund for federal income tax purposes.

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 in the Global Settlement Trust's opinion request, the Trust will not be subject to tax as a Dealer in Intangibles, as that term is defined in R.C. § 5725.01(B).

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 Global Settlement Trust to be aware of such changes. R.C. § 5703.53(E).

Roger W. Tracy,
Tax Commissioner

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