



**August 29, 2006**  
**Pennsylvania Corporate Taxes**  
**No. CRP-06-002**  
**Subjectivity - Business Trusts**  
**IRC § 468B Settlement Fund**

ISSUE

Is a trust that qualifies as an IRC § 468B settlement fund subject to the Pennsylvania Corporate Net Income or Capital Stock Franchise Taxes?

CONCLUSION

No. A trust that qualifies as an IRC § 468B settlement fund is not subject to the Pennsylvania Corporate Net Income or Capital Stock Franchise Taxes.

FACTS

In 1999, a corporation entered into a Settlement Agreement with representative parties in various class actions pending in Federal and State courts. Pursuant to the Settlement Agreement, the Settlement Trust (the "Trust") was established to receive funds to be paid by the corporation. The Trust administers the provision of benefits to members of the settlement class under the terms of the Settlement Agreement.

The largest portions of the funds in the Trust are used to administer and pay benefits directly to or for the benefit of individual members of the settlement class. Funds may be contributed by the Trust to a charitable foundation to be established to finance research and education related to heart disease; additional funds may be used to establish, operate and maintain a registry to be used to track medical conditions of members of the settlement class and for purposes of medical research and education.

The principal office of the trust is in Pennsylvania. The funds are invested by the trustees for the benefit of the beneficiaries, principally in publicly traded debt instruments.

For Federal income tax purposes, the Trust is a "qualified settlement fund" under Section 468B of the Internal Revenue Code of 1986, as amended (the "Code") and the regulations promulgated thereunder (Treas. Reg. §§ 1.468B-1 - 1.468B-5). 26 U.S.C. § 468B.

DISCUSSION

Section 601(a) of the Tax Reform Code defines the term "corporation" to include business trusts. 72 P.S. § 7601(a). Under the statute all business trusts, other than real estate investment trusts and regulated investment companies, doing business in the Commonwealth are subject to the Pennsylvania Capital Stock Franchise Tax. In addition, business trusts that are classified as corporations for Federal income tax purposes are subject to the Pennsylvania Corporate Net Income Tax. 72 P.S. § 7401 (definition of "corporation").

In 2001, Pennsylvania law was amended to provide that any entity that is classified as a corporation for Federal income tax purposes is subject to the corporate net income tax and the capital stock franchise tax. 72 P.S. §§ 7401(1) and 7601(a) (definition of "corporation").

The two underlying issues presented by your facts are whether a trust that qualifies as an IRC § 468B settlement fund is a business trust and whether an IRC § 468B settlement fund is classified as a corporation for Federal income tax purposes.

A "business trust" is a trust whose objective is to carry on a business and divide the profits therefrom. The objective of an IRC § 468B settlement fund is to resolve and satisfy tort claims against a party. 26 U.S.C. § 468B(d)(2). The objective is not to carry on a business and divide the profits. Therefore, a trust that qualifies as an IRC § 468B settlement fund is not a business trust.

With regard to the Federal classification of IRC 468B settlement funds, Treasury Regulation 1.468B-1 provides:

(b) Coordination with other entity classifications. If a fund, account, or trust that is a qualified settlement fund could be classified as a trust within the meaning of § 301.7701-4 of this chapter, it is classified as a qualified settlement fund for all purposes of the Internal Revenue Code (Code). If a fund, account, or trust, organized as a trust under applicable state law, is a qualified settlement fund, and could be classified as either an association (within the meaning of § 301.7701-2 of this chapter) or a partnership (within the meaning of § 301.7701-3 of this chapter), it is classified as a qualified settlement fund for all purposes of the Code. If a fund, account, or trust, established for contested liabilities pursuant to § 1.461-2(c)(1) is a qualified settlement fund, it is classified as a qualified settlement fund for all purposes of the Code.

26 C.F.R. § 1.468B-1 (emphasis added).

Pursuant to the above provision, a trust that qualifies as an IRC 468B settlement fund is not classified as a corporation. Rather, it is classified as a qualified settlement fund for purposes of Federal income tax. Accordingly, a trust that qualifies as an IRC § 468B settlement fund is not subject to the Pennsylvania Corporate Net Income or Capital Stock Franchise Taxes.