

200452050



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

SEP 28 2004

UICs: 408.02-01  
408.03-00

*T:EP:BA:T3*

LEGEND:

Taxpayer A =

Company M =

Insurance Company N =

Company O =

Individual D =

Individual E =

Company P =

Company Q =

Company R =

Company S =

Company T =

Court CP =

State S =

State T =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Months 1 and 2 =

Amount 1 =

Amount 2 =

Amount 3 =

Dear \_\_\_\_\_ :

This is in response to a ruling request dated March 20, 2004, concerning the status of a contribution to your individual retirement account (IRA).

The facts upon which you base your requests are as follows.

In \_\_\_\_\_ Taxpayer A terminated employment with Company M which sponsored one or more retirement plans represented to be qualified within the meaning of section 401(a) of the Internal Revenue Code in which Taxpayer A participated. At his termination, Taxpayer A was entitled to receive distributions from said retirement plans. Taxpayer A is a resident of State T.

Induced by representations made by employees of Company P, a licensed securities broker-dealer and Company Q, a registered investment advisor, Taxpayer A authorized Companies P and Q to manage the investment of his qualified retirement funds.

Upon the advice of representatives of Companies P and Q, Taxpayer A rolled over distributions received from the qualified retirement plan(s) maintained by Company M into an individual retirement annuity, described in Code section 408(b), issued by Insurance Company N. Taxpayer A rolled over Amount 1 on Date 1, \_\_\_\_\_. As of Date 2, \_\_\_\_\_, the value of Taxpayer A's IRA annuity had decreased significantly.

Insurance Company N is a State S corporation authorized to do business in State T. Insurance Company N sells financial products primarily to individuals. Most of its sales are made through independent financial advisors, and other distribution channels including, but not limited to, investment firms and financial institutions.

On or about Date 3, \_\_\_\_\_, Taxpayer A, along with other similarly situated taxpayers, filed a lawsuit in Court CP, State T, a court of competent jurisdiction, against Insurance Company N, Company O, the distributor of Insurance Company N products, Company P, Company Q, Company R, Company S, Individual D, and Individual E. Individuals D and E owned and operated Companies P, Q, R and S. The lawsuit alleged that Individuals D and E, and Companies P through S sold and/or recommended the IRA annuity purchased by Taxpayer A.

The lawsuit contains a factual allegation to the effect that "...Each Plaintiff signed a document captioned "Group Annuity Application for Participation" for submission to Insurance Company N. These applications were either signed by Individual D or Individual E, who was listed as "agent" along with a reference to Company P as the Agent's firm. ... the reference to either Individual D or Individual E as "agent" and to Company P as "firm" on the application itself was intended to indicate that Individual D and Individual E also was acting simultaneously as an agent of Insurance Company N in procuring the sale of the annuity..."

A sample "Group Annuity Application for Participation" attached to the copy of the lawsuit submitted with Taxpayer A's ruling request indicates that qualified IRA annuities may be purchased from Insurance Company N.

The lawsuit alleged that: (1) Companies P through S, and Individuals D and E breached their fiduciary duty to Taxpayer A by both advising him to purchase and selling him an IRA annuity as a vehicle to receive distributions made from qualified retirement plans; (2) Insurance Company N was vicariously liable for said breaches of fiduciary duty by its agents, Company P and Individuals D and E; (3) Companies P through S and Individuals D and E defrauded Taxpayer A by either intentionally misrepresenting or omitting material facts from him when they sold him his IRA annuity. Furthermore, Taxpayer A relied upon said misrepresentations when he purchased his IRA annuity. Finally, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they made the fraudulent misrepresentations and omissions; (4) all of the named defendants committed "constructive" fraud against Taxpayer A in selling him his IRA annuity. Furthermore, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they committed constructive fraud; (5) Companies P through S and Individuals D and E were negligent when they sold an IRA annuity to Taxpayer A which negligence caused the decline in value of Taxpayer A's IRA annuity. Furthermore, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they negligently recommended and sold the IRA annuity to Taxpayer A; and (6) Companies P through S and Individuals D and E negligently misrepresented and negligently failed to disclose material facts to Taxpayer A when they sold him his IRA annuity which negligence caused the decline in value of Taxpayer A's IRA annuity. Furthermore, Company P and Individuals D and E were acting within the scope of their duties as agents of Insurance Company N when they made their negligent misrepresentations and when they negligently failed to disclose material facts.

In Months 1 and 2, , Taxpayer A entered into a settlement agreement with Insurance Company N and Company O pursuant to which Insurance Company N agreed to pay Taxpayer A a sum of money in exchange for his agreeing to the dismissal of the above-referenced Date 3, , lawsuit. Under the terms of the settlement, Taxpayer A received Amount 2. In relevant part, Article 2 of the settlement provides that "...Insurance Company N shall make separate transfers of the surrender amounts for each of the Plaintiff's Annuities to Plaintiff's respective designees within seven (7) business days after the processing of such paperwork."

From the documentation contained in the file, it appears that the above-referenced settlement was the result of "arm's-length negotiations" between various parties with adverse interests.

Pursuant to the settlement agreement, the Date 3, lawsuit against Insurance Company N, Company O, Companies P through S, and Individuals D and E was dismissed.

On or about Date 4, , the above referenced Amount 2 payment was made, by check, from Insurance Company N to Taxpayer A. Said check was deposited into a trust account maintained by Taxpayer A's counsel. On or about Date 5, , a check in the amount of Amount 3 was issued by said counsel to Taxpayer A. Amount 3 represents Amount 2 less attorney's fees.

On or about Date 6, , Taxpayer A contributed Amount 3 into an IRA set up and maintained in his name with Company T. It has been represented that said contributory IRA met the requirements of Code section 408(a). Said Date 6, contribution was made within 60 days of Date 4, the date Amount 2 was paid to Taxpayer A.

It has been represented that, pursuant to Article 2 of the settlement agreement, the value of Taxpayer A's IRA annuity, which consisted of the IRA annuity value exclusive of amounts received as a result of the settlement referenced herein, less the applicable surrender charge, was transferred by Insurance Company N, by means of a direct trustee to trustee transfer, to the taxpayer's IRA account maintained with Company T.

It has also been represented that the sum of the settlement proceeds paid to Taxpayer A (Amount 3) and of the amounts transferred to Taxpayer A's Company T IRA (referenced in the paragraph immediately above) did not exceed Amount 1.

Based upon the foregoing, you request the following ruling:

That Taxpayer A's receipt of Amount 3 from Insurance Company N pursuant to the above described settlement of a lawsuit and its subsequent contribution into an IRA set up and maintained in his name with Company T constitutes a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code.

With respect to the requested letter ruling, section 408(a) of the Code provides that, for purposes of this section, the term "individual retirement account" means a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries, but only if the written governing instrument creating the trust meets certain requirements. Among these requirements is the one found in paragraph (1) of section 408(a) which states that, except in the case of a rollover contribution described in subsection (d)(3), in section 402(c), 403(a)(4), 403(b)(8), or 457 (e)(16), no contribution will be accepted unless it is in cash, and contributions will not be accepted for the taxable year in excess of the amount in effect for such taxable year under section 219(b)(1)(A) on behalf of any individual.

Section 408(d)(1) of the Code provides the general rule for the tax treatment of distributions from IRAs. This section provides, in pertinent part, that except as otherwise provided in subsection (d), any amount paid or distributed out of an individual retirement plan or under an individual retirement annuity shall be included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

Section 408(d)(3) of the Code establishes an exception to the contribution rules of section 408(a)(1) and the income inclusion rule of section 408(d)(1) for certain transactions characterized as rollover

contributions. Under section 408(d)(3), an amount is described in paragraph (3) as a rollover contribution if it meets the requirements of subparagraphs (A) and (B).

Subparagraph (A) of section 408(d)(3) of the Code states, in pertinent part, that paragraph (1) of section 408(d) does not apply to any amount paid or distributed out of an individual retirement account or individual retirement annuity to the individual for whose benefit the account or annuity is maintained if -- (i) the entire amount received (including money and any other property) is paid into an individual retirement account or individual retirement annuity (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

Subparagraph (B) of section 408(d)(3), in short, provides that this paragraph does not apply to any amount described in subparagraph (A)(i) received by an individual from an IRA account or annuity if at any time during the 1-year period ending on the day of such receipt such individual received any other amount described in that subparagraph from an IRA account or annuity which was not includible in his gross income because of the application of this paragraph.

With respect to the requested letter ruling, it has been represented that Taxpayer A and other similarly situated taxpayers, initiated a lawsuit in a court of competent jurisdiction against various defendants named in the lawsuit, including Insurance Company N, relating to a significant loss in value of IRA annuity, described in Code section 408(b), owned by Taxpayer A. The lawsuit alleged various causes of said loss of value relating to activities taken either by Insurance Company N, Company O, or other named parties allegedly acting as the Agents of Insurance Company N. Said lawsuit was settled. Pursuant to said settlement, Taxpayer A recovered, after attorney's fees were deducted, Amount 3, which he subsequently rolled into an IRA described in Code section 408(a) within 60 days of receipt.

The above reference settlement proceeds were designed to replace a portion of Taxpayer A's IRA annuity amounts lost due to alleged misconduct on the part of a number of defendants including Insurance Company N. No distribution occurred until the issuance of the check in Amount 2 by Insurance Company N.

Accordingly, based on the particular facts and representations contained herein, we hold that Taxpayer A's receipt of Amount 3 from Insurance Company N as the replacement of a portion of his original IRA annuity, pursuant to the above-reference lawsuit settlement and the payment of this amount to the newly-established individual retirement account at Company T, represents a valid rollover.

Thus, with respect to your ruling request, we conclude as follows;

That Taxpayer A's receipt of Amount 3 from Insurance Company N pursuant to the above described settlement of a lawsuit and its subsequent contribution into an IRA set up and maintained in his name with Company T constitutes a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code.


This ruling letter is based on the assumption that Taxpayer A's IRA annuity was described in Code section 408(b) as represented. It also assumes that the contributory IRA set up and maintained in

the name of Taxpayer A, described above, meets the requirements of Code section 408(a) as represented. Additionally, it assumes the correctness of all facts and representations made with respect thereto.

A copy of this letter has been sent to your authorized representatives in accordance with a power of attorney on file in this office.

If you have any questions concerning this letter ruling, please contact \_\_\_\_\_, Esquire  
who may be reached at \_\_\_\_\_ (not a toll-free number) or  
(FAX).

Sincerely yours,



Frances V. Sloan, Manager,  
Employee Plans Technical Group 3

Enclosures:  
Deleted copy of this letter  
Notice of Intention to Disclose