

## SUPPLEMENTARY INFORMATION:

### *Paperwork Reduction Act*

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1465. This information is required by the IRS to ensure the proper reporting of items of income and expense of an environmental remediation trust in which a portion of the trust is treated as owned by a grantor.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent is 4 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

### *Background*

On August 4, 1995, the IRS published in the **Federal Register** a notice of proposed rulemaking (60 FR 39903 [PS-54-94, 1995-37 I.R.B. 48]) to provide guidance on the classification of certain organizations as trusts for federal tax purposes. Written comments responding to the notice were received, and a public hearing was held on October 26, 1995. After consideration of the comments received, the proposed regulations are adopted as revised by this Treasury decision.

### *Summary of Significant Comments and Revisions*

The proposed regulations provide that an environmental remediation trust

is considered a trust for purposes of the Internal Revenue Code. Under the proposed regulations, a trust is an environmental remediation trust if the primary purpose of the trust is collecting and disbursing amounts for environmental remediation of an existing waste site. One commentator suggested that “response costs” should be considered amounts incurred for environmental remediation. To address this concern, the final regulations clarify that environmental remediation includes the costs of remedying and removing environmental contamination. One commentator also suggested that the final regulations define the term *existing waste site*. The final regulations do not adopt this comment. The term existing waste site should be sufficiently specific to allow taxpayers to establish an environmental remediation trust for any contaminated site that currently requires remediation under environmental laws.

The proposed regulations provide that all contributors to an environmental remediation trust must have potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for environmental remediation of the waste site. A commentator suggested that the final regulations be clarified to provide that eligible contributors include contributors with “actual” as well as potential liability and contributors who are released from liability upon their contribution to the trust. The final regulations clarify that contributors having “actual” liability are eligible contributors. The final regulations do not address the treatment of contributors that are released from liability by the governmental authority upon contribution to the trust; the regulations are intended only to address the tax treatment of environmental remediation trusts in which contributors continue to have actual or potential liability (and thus are treated as owners of the trust under section 677). In situations where one or more contributors are released from liability by the governmental authority upon contribution to the trust, the rules for qualified settlement funds may apply to the entire trust. See §1.468B-1(c) and (h)(2). If such contributors contribute amounts to a trust that is separate from the environmental remediation trust, however, the classi-

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## Section 7701.—Definitions

26 CFR 301.7701-4: Trusts.

T.D. 8668

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Parts 1, 301, and 602

### Environmental Settlement Funds- Classification

AGENCY: Internal Revenue Service  
(IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations relating to the classification of certain organizations as trusts for federal tax purposes. The final regulations provide guidance to taxpayers on the proper classification of trusts formed to collect and disburse amounts for environmental remediation of an existing waste site to discharge taxpayers' liability or potential liability under applicable environmental laws.

DATES: These regulations are effective May 1, 1996.

For dates of applicability, see §301.7701-4(e)(5).

FOR FURTHER INFORMATION  
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622-3060 (not a toll-free number).

fication of the environmental remediation trust as a trust will not be affected.

One commentator suggested that a cross-reference to these regulations be inserted in §1.671-4(a) and §1.677(a)-1(d) because the proposed regulations address reporting and grantor trust issues. The final regulations include the suggested cross-references.

Other commentators suggested that the final regulations address the timing of deductions for contributions to the trust, the treatment of interest earned by the trust, and other federal tax consequences of the trust. The final regulations do not adopt these suggestions. The regulations are limited to the classification of an environmental remediation trust as a trust for purposes of section 7701 and do not address or affect the timing or amount of a deduction for environmental remediation costs. Amounts contributed to an environmental remediation trust and interest earned on those amounts must be taken into account under the appropriate federal tax accounting rules, including the economic performance rules of section 461(h). Under those rules, taxpayers generally cannot deduct contributions to the trust at the time of contribution or deduct earnings at the time they are received by the trust.

The proposed regulations provide that the regulations will apply to trusts formed on or after the date of publication of final regulations. One commentator suggested that the final regulations should be effective, at the trustee's option, to trusts meeting the requirements of an environmental remediation trust established prior to such date, effective as of any date designated by the trustee. The commentator further suggested that, with respect to amounts held in a fund, account, or trust meeting the requirements of an environmental remediation trust prior to the date of publication of the final regulations, the IRS should not challenge the classification of the fund, account, or trust as a trust for federal tax purposes.

The final regulations are effective for trusts meeting the definition of an environmental remediation trust that are formed on or after May 1, 1996. The final regulations may be relied on by trusts formed before May 1, 1996, if the trust has at all times met all requirements of the final regulations and the grantors reported items of

income and deduction consistent with the final regulations on original or amended returns. This provision allows a trust and grantors that have met all of the requirements of the final regulations throughout the existence of the trust to treat the trust as an environmental remediation trust. The final regulations also provide that, for trusts formed before May 1, 1996, that are not described by the preceding rule, the Commissioner may permit by letter ruling, in appropriate circumstances, the final regulations to be applied subject to appropriate terms and conditions.

### *Special Analyses*

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

### *Drafting Information*

The principal author of these regulations is James A. Quinn of the Office of Assistant Chief Counsel (Pass-throughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

### *Amendments to the Regulations*

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

## PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805

Par. 2. Section 1.671-4 is amended by adding a sentence at the end of paragraph (a) to read as follows:

### *§1.671-4 Method of reporting.*

(a) Section 301.7701-4(e)(2) of this chapter provides guidance on how these reporting rules apply to an environmental remediation trust.

Par. 3. Section 1.677(a)-1 is amended by adding a sentence at the end of paragraph (d) to read as follows:

### *§1.677(a)-1 Income for benefit of grantor; general rule.*

(d) See §301.7701-4(e) of this chapter for rules on the classification of and application of section 677 to an environmental remediation trust.

## PART 301—PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues to read as follows:

Authority: 26 U.S.C. 7805

Par. 5. Section 301.7701-4(e) is added to read as follows:

### *§301.7701-4 Trusts.*

(e) *Environmental remediation trusts.* (1) An environmental remediation trust is considered a trust for purposes of the Internal Revenue Code. For purposes of this paragraph (e), an organization is an environmental remediation trust if the organization is organized under state law as a trust; the primary purpose of the trust is collecting and disbursing amounts for environmental remediation of an existing waste site to resolve, satisfy, mitigate, address, or prevent the liability or potential liability of persons imposed by federal, state, or local environmental laws; all contributors to the trust have (at the time of contribution and thereafter) actual or potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for environmental remediation of the waste site; and the trust is not a qualified settlement fund within the meaning of §1.468B-1(a) of this chapter. An environmental remediation trust is classified as a trust because its primary purpose is environmental remediation of an existing waste site and

not the carrying on of a profit-making business that normally would be conducted through business organizations classified as corporations or partnerships. However, if the remedial purpose is altered or becomes so obscured by business or investment activities that the declared remedial purpose is no longer controlling, the organization will no longer be classified as a trust. For purposes of this paragraph (e), environmental remediation includes the costs of assessing environmental conditions, remedying and removing environmental contamination, monitoring remedial activities and the release of substances, preventing future releases of substances, and collecting amounts from persons liable or potentially liable for the costs of these activities. For purposes of this paragraph (e), persons have potential liability or a reasonable expectation of liability under federal, state, or local environmental laws for remediation of the existing waste site if there is authority under a federal, state, or local law that requires or could reasonably be expected to require such persons to satisfy all or a portion of the costs of the environmental remediation.

(2) Each contributor (grantor) to the trust is treated as the owner of the portion of the trust contributed by that grantor under rules provided in section 677 and §1.677(a)-1(d) of this chapter. Section 677 and §1.677(a)-1(d) of this chapter provide rules regarding the treatment of a grantor as the owner of a portion of a trust applied in discharge of the grantor's legal obligation. Items of income, deduction, and credit attributable to an environmental remediation trust are not reported by the trust on Form 1041, but are shown on a separate statement to be attached to that form. See §1.671-4(a) of this chapter. The trustee must also furnish to each grantor a statement that shows all items of income, deduction, and credit of the trust for the grantor's taxable year attributable to the portion of the trust treated as owned by the grantor. The statement must provide the grantor with the information necessary to take the items into account in computing the grantor's taxable income, including information necessary to determine the federal tax treatment of the items (for example, whether an item is a deductible expense under section 162(a) or a capital expenditure under section 263(a)) and how the item should be taken into account under the

economic performance rules of section 461(h) and the regulations thereunder. See §1.461-4 of this chapter for rules relating to economic performance.

(3) All amounts contributed to an environmental remediation trust by a grantor (cash-out grantor) who, pursuant to an agreement with the other grantors, contributes a fixed amount to the trust and is relieved by the other grantors of any further obligation to make contributions to the trust, but remains liable or potentially liable under the applicable environmental laws, will be considered amounts contributed for remediation. An environmental remediation trust agreement may direct the trustee to expend amounts contributed by a cash-out grantor (and the earnings thereon) before expending amounts contributed by other grantors (and the earnings thereon). A cash-out grantor will cease to be treated as an owner of a portion of the trust when the grantor's portion is fully expended by the trust.

(4) The provisions of this paragraph (e) may be illustrated by the following example:

*Example.* (a) *X, Y, and Z* are calendar year corporations that are liable for the remediation of an existing waste site under applicable federal environmental laws. On June 1, 1996, pursuant to an agreement with the governing federal agency, *X, Y, and Z* create an environmental remediation trust within the meaning of paragraph (e)(1) of this section to collect funds contributed to the trust by *X, Y, and Z* and to carry out the remediation of the waste site to the satisfaction of the federal agency. *X, Y, and Z* are jointly and severally liable under the federal environmental laws for the remediation of the waste site, and the federal agency will not release *X, Y, or Z* from liability until the waste site is remediated to the satisfaction of the agency.

(b) The estimated cost of the remediation is \$20,000,000. *X, Y, and Z* agree that, if *Z* contributes \$1,000,000 to the trust, *Z* will not be required to make any additional contributions to the trust, and *X* and *Y* will complete the remediation of the waste site and make additional contributions if necessary.

(c) On June 1, 1996, *X, Y, and Z* each contribute \$1,000,000 to the trust. The trust agreement directs the trustee to spend *Z's* contributions to the trust and the income allocable to *Z's* portion before spending *X's* and *Y's* portions. On November 30, 1996, the trustee disburses \$2,000,000 for remediation work performed from June 1, 1996, through September 30, 1996. For the six-month period ending November 30, 1996, the interest earned on the funds in the trust was \$75,000, which is allocated in equal shares of \$25,000 to *X's, Y's, and Z's* portions of the trust.

(d) *Z* made no further contributions to the trust. Pursuant to the trust agreement, the trustee expended *Z's* portion of the trust before expend-

ing *X's* and *Y's* portion. Therefore, *Z's* share of the remediation disbursement made in 1996 is \$1,025,000 (\$1,000,000 contribution by *Z* plus \$25,000 of interest allocated to *Z's* portion of the trust). *Z* takes the \$1,025,000 disbursement into account under the appropriate federal tax accounting rules. In addition, *X's* share of the remediation disbursement made in 1996 is \$487,500, and *Y's* share of the remediation disbursement made in 1996 is \$487,500. *X* and *Y* take their respective shares of the disbursement into account under the appropriate federal tax accounting rules.

(e) The trustee made no further remediation disbursements in 1996, and *X* and *Y* made no further contributions in 1996. From December 1, 1996, to December 31, 1996, the interest earned on the funds remaining in the trust was \$5,000, which is allocated \$2,500 to *X's* portion and \$2,500 to *Y's* portion. Accordingly, for 1996, *X* and *Y* each had interest income of \$27,500 from the trust and *Z* had interest income of \$25,000 from the trust.

(5) This paragraph (e) is applicable to trusts meeting the requirements of paragraph (e)(1) of this section that are formed on or after May 1, 1996. This paragraph (e) may be relied on by trusts formed before May 1, 1996, if the trust has at all times met all requirements of this paragraph (e) and the grantors have reported items of income and deduction consistent with this paragraph (e) on original or amended returns. For trusts formed before May 1, 1996, that are not described in the preceding sentence, the Commissioner may permit by letter ruling, in appropriate circumstances, this paragraph (e) to be applied subject to appropriate terms and conditions.

## PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In §602.101, paragraph (c) is amended by adding the entry “301.7701-4(e) .... 1545-1465” in numerical order to the table.

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

Approved April 5, 1996.

Leslie Samuels,  
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on April 30, 1996, 8:45 a.m., and published in the issue of the Federal Register for May 1, 1996, 61 F.R. 19189)