Tax Accounting

By James E. Salles

This month's column discusses *United States v. Brown*,[1] in which the Tenth Circuit upheld the regulations under section 468B(g) concerning "qualified settlement funds" ("QSFs"). The court applied the regulations to a court-supervised receivership, and also addressed several issues concerning their interpretation.

The procedural history of the *Brown* case at the appellate level is a little unusual. The Tenth Circuit issued its published opinion in July, 2003. The taxpayers requested reconsideration and petitioned for a rehearing *"en banc"* by the full Tenth Circuit. The petition for rehearing by the full court was denied. In November, however, the panel withdrew its opinion in favor of a revised opinion that reached the same result but modified one portion of the discussion. Interestingly, the court chose not to publish the revised opinion. The published opinion has thus been vacated, while the substitute opinion technically lacks precedential value. The earlier opinion, however, is likely to continue to be cited to the extent not affected by the modification, the more so as there is little other authority on the issues that it addresses.

Traditional Rules

Understanding what the parties were arguing about in *Brown* requires an understanding of the QSF regulations' provisions and purpose. This in turn requires some background in the "traditional" rules for trusts, escrows, and similar arrangements that preceded them, and which still apply to the extent that the regulations have not displaced them.

Common escrow arrangements, or setting aside money to pay debt, or disputed or contingent claims, may result in a trust.[2] An arrangement is generally treated as a trust if its purpose is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility."[3] Sometimes, however, a custodian or agent may not have sufficient investment and administrative autonomy to be considered a trustee.[4] For example, a court, or a bank that is merely a passive stakeholder, will not be a trustee.[5] Whether or not the arrangement is a trust, the basic dividing line is drawn between property that is segregated to secure or provide for payment of an obligation of the settlor ("transferor"), and cases where tax ownership has actually been transferred, but for reasons of security or administrative convenience the transferred property continues to be held by a trustee or agent awaiting distribution.

Transferor Taxation

The grantor trust rules normally apply if the grantor retains significant reversionary rights or the trust accumulates income for future distribution to the grantor.[6] Early Supreme Court cases established,[7] and the Regulations now provide,[8] that these provisions extend to trusts that accumulate income that may be applied to meet the transferor's future or contingent obligations.[9] Thus, for example, *In re Sonner*[10] taxed a bankruptcy debtor on income in a post-confirmation liquidating trust when the trust's assets were to be sold and applied against his liabilities.[11]

The Supreme Court in *Holywell Corporation v. Smith*[12] declined to apply the grantor trust provisions in a similar setting when the assets passed to the trust directly from the bankruptcy estate, distinguishing *Sonner* as a case where the assets had been constructively distributed to the debtor before being transferred to the trust. However, the question of whether the debtor or the bankruptcy estate was the grantor seems only to have been important because the bankruptcy estate of an individual is a separate taxable entity.[13] Corporate debtors' bankruptcy estates are not separate taxable entities, and the court and the parties assumed without discussion that a related corporate debtor was taxable on income from a similar trust, although the parties disagreed about who was responsible for filing the corporation's return and paying the associated tax.[14]

If the arrangement does not create a trust, the end result will be much the same, apart from the responsibility for filing a return and information reporting, because the transferor will be treated as beneficial owner of the property itself while it is

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held by the custodian. The authority frequently cited for this proposition is Reg. § 1.61-13, which addresses corporate "sinking funds."[15] The regulation, however, merely expresses the general principle that income from property is taxed to its owner. Indeed, the early Supreme Court cases involving trusts relied more on bedrock principles of ownership than on the statutory grantor trust provisions.[16]

Transferee Taxation

The other basic taxation model applies after there has been a transfer of beneficial ownership of property in the fund. It was early settled that escrowed sales proceeds could be treated as property of the seller.[17] Some early cases simply deemed the seller to have received the money and placed it into escrow.[18] The later trend was to consider the seller as having received a vested interest in segregated assets,[19] which is itself a form of "property."[20] That the interest might be forfeited for future nonperformance would not prevent the seller's rights from vesting for this purpose. By the same logic, if the sold property is escrowed to secure the buyer's obligations, the buyer is treated as its owner once the benefits and burdens of ownership have passed.[21] Similar principles apply in settings not involving dispositions of property. For example, the Tax Court recently treated a taxpayer as receiving litigation proceeds held in his attorney's trust account pending resolution of a fee dispute.[22]

Normal tax principles govern such a transfer of ownership. Not every transfer of fund property represents a "payment" or causes a "receipt," just as not every cash remittance does. A deposit or a loan, for example, transfers tax ownership without being a recognition event to either party.[23] However, if fund property is applied against the transferor's liability, the transfer of ownership ordinarily marks the "payment." Correspondingly, the transferee(s), if identifiable, will have a "receipt," and in most cases will be taxable on future income from the property either under the grantor trust rules or as direct owners.

In *Johnson v. Commissioner*,[24] an auto dealer put part of its proceeds from service contract sales into a trust. The Tax Court rejected the dealer's argument that it held the receipts in trust for its customers. The court concluded that the customers had given up rights to the amounts that they paid, and that the trust was to secure the *dealer's* conditional obligation to make refunds. Consequently, the dealer was taxable as owner of a grantor trust. Similarly, in Revenue Ruling 63-228,[25] the trustee for a bankrupt partnership distributed property in kind to a liquidating trust for benefit of creditors. The ruling treated the creditors as having received undivided interests in the property which they then transferred to the trust, so that the liquidating trust was a grantor trust with respect to them. Reporting aside, the results would have been much the same in both cases if the trustees were "mere" agents.

Analyzing Potential Transfers

Sometimes it is hard to tell if the transferor or transferee taxation model should apply. The critical question is whether the fund property secures a future obligation of the original transferor or whether it has already been applied to pay that obligation. Once property has been applied to satisfy an obligation, the transferor is no longer its beneficial owner. By contrast, the transfer of an obligation *secured* by a trust or other fund may also be a taxable event,[26] but does not affect tax ownership of the collateral.

The distinction between property that secures an obligation and property that has been applied against an obligation is illustrated in three early Supreme Court cases. In *Douglas v. Willcuts*[27] and *Helvering v. Leonard*[28] the Court taxed settlors on income of an alimony trust for benefit of their ex-wives, because the Court determined that they remained subject to continuing liabilities for which the trust only served as security. On the other hand, in *Helvering v. Fuller*,[29] the wife was held taxable when the divorce decree left the husband "no continuing obligation, contingent or otherwise" and no right to reversion of the property.

The same line seems to divide cases such as *Sonner*, where the trust assets were to be sold and the proceeds applied to the debtor's liabilities, from Revenue Ruling 63-228, where the property was actually transferred to the creditors. *Holywell* implicitly reinforces the analysis in the earlier Supreme Court cases discussed above. The individual's liquidating trust was held separately taxable because the grantor trust provisions did not apply, but the income of the corporation's trust was simply assumed to be attributable to the debtor. The possibility that either trust might be a grantor trust as to the *creditors* was not considered, evidently because the assets had not been applied to the debtors' liabilities.

The alimony trust cases considered both

whether the settlor husbands retained any rights to the trust property and whether their continuing liabilities had been extinguished. The key consideration seems to be the status of the property rather than the liability. Confirmation of the bankruptcy plans in *Holywell* and *Sonner* may have limited the debtors' liability,[30] but the debtors retained beneficial ownership and — in *Holywell*,[31] and probably in *Sonner* – at least theoretically had the right to anything left over. This was evidently enough to continue to tax the debtors on the income from the property. This conclusion is reinforced by authorities holding that nonrecourse liabilities are still liabilities of the grantor for purposes of determining whether amounts are being accumulated to meet the grantor's liabilities.[32]

The "Homeless Fund" Problem

The basic analysis described above may give way to specific Code provisions. Section 402(b), for example, provides that "employees' trusts" will not be grantor trusts as to the beneficiaries. If the transferor/employer has transferred ownership — that is, if the assets do not merely serve as security — the trust will pay tax on its own undistributed income. Beneficiaries are taxed upon distributions from the trust's income, although under the rules applicable to annuities rather than the conventional trust rules. Beneficiaries that are "highly-compensated employees" may also be taxable on increases in the value of their interest in the undistributed assets in the trust. Alimony trusts now fall under section 682, which taxes divorced or separated spouses on trust income distributable to them that would otherwise be taxed to their ex-spouse.[33]

In each of the cases discussed above, however, the income from the trust property is being taxed either to the transferor, the transferee, or to the trust itself. The real problem arises when the transferor has given up all rights to the property and has been discharged of its obligation, but the transferees' identity is uncertain. This situation can come about because the interests of individual beneficiaries have yet to be determined, or because of disputes among the beneficiaries, or both. Traditional tax principles do not justify taxing the transferor as the owner of property to which it has given up all rights.[34] On the other hand, unidentified beneficiaries cannot be taxed on receipt of the property itself or on income that it may earn.

If the arrangement creates a trust, and the grantor trust rules do not apply, the trust will be currently taxable on its own income. Beneficiaries are taxed on distributions from trust income, and also potentially taxable as they receive principal, depending on the nature of their claims. However, in the "olden days," if the arrangement did not create a trust, there was no one to tax on undistributed income. Courts and the IRS glumly settled on taxing the transferees of these so-called "homeless funds" on principal and accumulated income when ownership was determined.[35]

Contested Liabilities: Section 461(f)

Contested liabilities add an additional wrinkle. The Supreme Court held in *United States v. Consolidated Edison Co. of New York*[36] that an accrual taxpayer could not deduct amounts paid against a contested liability. Disputed liabilities do not meet the "all events" test,[37] and the Court held that the payments did not change the result because the remittances were necessarily "mere deposits" pending the outcome of the dispute. The Court's "deposit theory" seemed to deny both cash and accrual taxpayers deductions even for amounts that were paid over, with no strings attached, pending the outcome of the dispute. This seemed especially unfair because in such circumstances the claimant would likely have to treat the amount as a receipt under claim of right, not a deposit.

Congress responded to the problem posed by *Consolidated Edison* in section 461(f), which provides that (except for foreign taxes) if a contest of the liability is the only obstacle to a deduction, the deduction is allowed when "the taxpayer transfers money or other property to provide for satisfaction of the liability." A "transfer to provide for satisfaction" of a liability may stop short of a payment. The regulations allow transfers to an escrow agent or trustee if under either a written agreement among the parties, or a court or agency order.[38]

Section 461(f) eliminated the mismatch created by *Consolidated Edison* at the cost of creating a new one. *Consolidated Edison* treated remittances that would normally be payments as deposits, denying transferors deductions even though the transferees might have income. Section 461(f) reversed the potential mismatch by treating a transfer to a fund securing a contingent liability — which would not ordinarily represent income to the claimant -- as the equivalent of a payment. This posed the question of who owned the property in the fund, and had to

report its income. The regulations specifically reserved on the subject.[39] If the arrangement creates a trust, and the grantor trust rules do not apply, the trust is probably taxable in its own right under normal trust rules.[40] Absent a trust, however, section 461(f) simply adds to the ranks of potential "homeless funds."

Section 468b and the QSF Regulations

The Deficit Reduction Act of 1984 ("DEFRA") modified the traditional "all events" test governing accrual method taxpayers. Accrual taxpayers traditionally took liabilities into account when they were fixed and their amount could be determined with "reasonable accuracy." After DEFRA, there must also be "economic performance" as to the liability.[41] The statute specified that "economic performance" occurred as to workers' compensation and tort liabilities upon payment to the person asserting the liability.[42] Regulations later extended this payment requirement to most other liabilities apart from those incurred for property, services, or the use of property.[43] Section 461(f) funds are of little use to accrual taxpayers if the dispute involves a liability subject to economic performance. "Payment" means a remittance that would entitle a cash basis taxpayer to a deduction and require a cash basis recipient to include income. Purchasing an asset to fund a liability is not treated as "payment" unless ownership of that asset is transferred to the claimant.[44]

"Designated Settlement Funds"

Congress moved to address some of the resulting problems in the Tax Reform Act of 1986. The 1986 Act added section 468B, which was enacted as a technical amendment retroactive to enactment of the economic performance rules,[45] on the grounds that DEFRA had left it unclear when payment into a settlement fund qualified as economic performance.[46]

Section 468B prescribed rules for "designated settlement funds" (DSF's) to provide for settlement of tort-like liabilities "arising out of personal injury, death, or property damage." "Qualified payments" to DSFs are treated as economic performance of covered liabilities. Except as provided in regulations, payments into other trusts or funds are not.[47] DSF's were thus envisioned as the exclusive means by which accrual taxpayers could deduct payments into settlement funds with respect to covered liabilities.

The statute provides for treatment of DSFs as separate entities taxable on their own income. DSF status requires an explicit election, and the fund has to meet several restrictive requirements:

- The fund must be established to resolve or satisfy claims arising out of personal injury, death, or property damage.
- It must be established pursuant to a court order and completely extinguish the settlor's liability.
- It must only accept "qualified payments," and be administered by persons a majority of whom are independent of the settlor. Neither the settlor nor any related person may have any beneficial interest in the fund.[48]

DSF's could not be funded while the claims were contested.[49] Moreover, the restrictions on the types of claims for which DSFs were available posed significant obstacles to their use. Complex litigation often involves a smorgasbord of claims, some of which might be eligible for DSF treatment and some not.

Section 468B(g)

The same section of the 1986 Act addressed "homeless funds."[50]

> Nothing in any provision of law shall be construed as providing that an escrow account, settlement fund, or similar fund is not subject to current income tax. The Secretary shall prescribe regulations providing for the taxation of any such account or fund whether as a grantor trust or otherwise.

The quoted language, later codified by another technical amendment[51] as section 468B(g), applied to accounts or funds established after August 16, 1986. The 1986 Act legislative history observed that if the transfer to a fund were nondeductible, the fund should be treated as a grantor trust.[52] The report accompanying the codification was somewhat more forthcoming:

> It is anticipated that these regulations will provide that if the amount is transferred pursuant to an arrangement that constitutes a trust, then the income earned by the amounts transferred will be currently taxed under Subchapter J of the Code. Thus, for example, if the transferor retains a reversionary interest in any portion of the trust

that exceeds 5 percent of the value of that portion, or the income of the trust may be paid to the transferor, or may be used to discharge a legal obligation of the transferor, then the income is currently taxable to the transferor under the grantor trust rules.[53]

Treasury and the IRS might have followed the legislative history and used the authority granted by section 468B(g) to address the narrow question of "homeless funds," possibly extending the period during which the transferor was treated as owning the property and treating some non-trust arrangements as trusts. They instead developed a remedy for the DSF regime's inadequacies that also covered some (but not all) potential "homeless funds."

Requirements for QSF Status

Regulations under section 468B(g) were proposed in early 1992 and issued in final form at the end of that year. These regulations set out rules for taxing "qualified settlement funds," or QSFs, which were basically a broader and mandatory version of the statutory DSF regime. The regulations boil the requirements for QSF status down to three:

Firstly, the fund must be "established pursuant to an order of, or . . . approved by," a court, agency, or other "instrumentality" of government, and be subject to its continuing jurisdiction.[54] An out-of-court settlement, for example, is not acceptable.[55] Arbitration awards will generally qualify if the fund remains subject to the continuing jurisdiction of the panel or supervising government authority.[56]

Secondly, the fund must be "established to resolve or satisfy" one or more "allowable liabilities" resulting from past events. "Allowable liabilities" are confined to those that arise under Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA)[57] or "out of a tort, breach of contract, or violation of law," except as the IRS may provide in a revenue ruling or procedure. Since economic performance of an obligation to provide property or services does not occur until these are actually provided, these types of obligations are generally not "allowable liabilities" unless the obligation is to provide services or property to the fund itself.[58] Finally, again except as provided by ruling or procedure, the regulations specifically exclude from "allowable liabilities":

- Liabilities for workers compensation and health benefits;
- Routine refunds, repairs, and replacements relating to "products regularly sold in the ordinary course of the transferor's trade or business"; and
- Liabilities to the general run of creditors in bankruptcy or other insolvency settings.[59]

QSFs may also accept transfers relating to "non-allowable liabilities," but as discussed below, accrual basis taxpayers will not get a current deduction for such transfers.[60]

The third and final requirement for QSF status is that the fund must either be a trust under state law (although the state law trust may be a business entity under federal tax principles[61]), or else the fund assets must be otherwise segregated, such as in a separate bank account.[62] The fund need not, however, be protected against the transferors' creditors.[63]

Taxation of the Fund and Its Transferor(s)

The taxation of QSF's and their transferors is consistent with the statutory DSF regime. The fund pays tax on its "modified gross income" at the maximum trust rate, but is otherwise taxed much like a corporation. Generally, a QSF's "modified gross income" is the income from its property minus administrative expenses. The fund does not report amounts transferred in to pay claims as income, nor does it deduct distributions to claimants or other payments on behalf of the transferor.[64]

Transferors' deductions depend on their method of accounting and the nature of the liability. Economic performance of liabilities relating to services, property, or the use of property occurs as the consideration is provided.[65] Otherwise, apart from certain specified liabilities and interest,[66] economic performance occurs upon a payment — determined under general tax principles — to the person asserting the liability.[67] In most cases, QSF's are encountered in connection with these "payment liabilities."

Section 468B provides that economic performance of a liability eligible for DSF treatment occurs when a "qualified payment" is made to a DSF, and not upon payment into any other type of fund, except as provided in regulations.[68] The DSF thus steps into the shoes of the claimants for the purposes of receiving a payment. The QSF regulations carry over the same approach. Economic performance of an allowable liability generally occurs when the transfer is made to the QSF. However, transfers of the taxpayer's own obligation, or that of a related

party, will not qualify as a transfer for this purpose. As under general tax principles, a taxpayer cannot pay an obligation by simply promising to pay or otherwise perform.[69]

Moreover, even if cash or property is transferred into the fund, economic performance will not occur while the transferor retains either

- A current right to refund or reversion exercisable without the consent of an independent or adverse party; or
- A right to a refund subject only to conditions that are certain to occur, such as the passage of time.[70]

In other words, a deduction is not allowed for a remittance while the payer has a current right to a refund or a fixed right to an eventual refund. These rules basically codify the "common law" rules for distinguishing a true "payment" from a deposit.

The regulations do not address cash basis transferors' deductions. However, cash basis taxpayers generally deduct or otherwise take into account liabilities upon payment, which is likely to take place when economic performance occurs under the rules described above. As cash basis taxpayers' deductions are independent of "economic performance" and the regulations, the restriction to payments in respect of "allowable claims" and the rule disregarding transfers of related party obligations should not apply. As discussed below, however, such a transferor might be taxed when the fund makes a distribution in respect of non-allowable claims.

Whether or not the transfer itself is deductible, transferors generally recognize gain or loss upon property transferred to the fund, although losses may be restricted in certain circumstances.[71] Apart from administrative expenses, any amount distributed by the fund except in satisfaction of allowable claims is deemed to be distributed to the transferor(s). Transferors are potentially taxable to the extent the distribution represents the return of amounts previously deducted,[72] but then are entitled to treat the amount as though they had paid the actual recipient of the distribution directly.[73]

A Mixed Blessing

The QSF regulations made the restrictions on DSFs — and the statutory election — academic. Any arrangement that would have qualified to be a DSF will be a QSF, whether the parties like it or not.[74] QSF's cover a broader class of "allowable claims," need not completely extinguish the transferor's liabilities, and may be funded while the liabilities are still being contested. Moreover, while DSF's were limited to accepting "qualified payments," QSFs may accept transfers that do not qualify for deductions, either because they do not meet the standard for economic performance or because they relate to "non-allowable claims." Thus, the QSF rules extend well beyond what would have been "homeless funds" under pre-1986 law, and reach many funds that traditionally would have been treated as trusts, or as owned by one or another party.

The regulations' broad sweep has attracted comment because QSF status can be a mixed blessing. The QSF rules provide administrative certainty and a potential acceleration of transferors' deductions, at the cost of what is sometimes described as double taxation of the fund's income. For example, consider a taxpayer that pays $100 into a fund that earns $20 in income, paying $8 in tax, and then distributes its assets to claimants. The transferor gets only a $100 deduction, while the claimants are potentially taxed on $112. Had the transferor instead kept the assets, it would have had to pay tax on the $20 in income, but then it would have gotten a deduction for $112. This result is theoretically reasonable because the transferor gets a deduction when it pays the fund rather than when the fund pays the claimants. However, if the transferor is in financial difficulties—as is frequently the case—the accelerated deduction may do it little good. Possibly for this reason, proposed regulations would allow an election to treat a QSF with only one transferor as a grantor trust.[75] Except for certain government-sponsored funds, however, such an election would only be available for funds established after final regulations are published.[76]

On the other hand, despite their broad application, the QSF rules do not provide a comprehensive solution for the "homeless fund" problem. As to other potential "homeless funds" that are not QSFs, section 468B(g) makes clear that "no current taxation" is not an acceptable answer,[77] but does not tell us what is. In 1999, the IRS proposed further regulations that would cover other court-supervised funds holding property that is "subject to conflicting claims of ownership."[78]

The *Brown* Case

In *United States v. Brown*,[79] a group of domestic

and offshore entities (the Wellshire group) transferred property into court-supervised receivership in settlement of German customers' claims for securities fraud. While the transfer enabled the Wellshire group to obtain the release of certain other property, the group members were not relieved of further liability. The assets apparently appreciated between the transfer and when the receiver liquidated them to pay claims. The IRS filed a claim in the receivership proceeding on the grounds that the receivership estate was a QSF and owed tax. The receiver and the non-settling claimants (henceforth, the "taxpayers") objected.

Qualification of a QSF

The district court held that the receivership estate failed the regulations' second requirement for QSF status because the fund was not established to "resolve or satisfy" the securities claims. The court reasoned that the immediate purpose of the receivership was to provide for restitution. The property in the hands of the receiver was inadequate to satisfy the asserted liabilities of the Wellstone group, which had been neither determined nor discharged. Moreover, the court held that one of the main purposes of the QSF rules was to allow the transferors to obtain deductions, and the court concluded that the identity of the transferor(s) could not be determined because of the ongoing disputes over ownership of various securities.

The Tenth Circuit, however, held that the requirement that the fund be established to "resolve or satisfy" claims of the indicated type did not require that the transferors be discharged of liability. Unlike the court below, the appellate panel accorded significance to the regulations' omission of the statutory requirement that the fund "completely extinguish" the transferors' liability. The transferors would, of course, be relieved of liability to the extent that the transferred assets were used to pay claims against them, but their further liability was irrelevant.

The appellate court also found the taxpayers' contentions about the identity of the transferors to be beside the point. A taxpayer that exercises dominion and control over property is its owner for tax purposes, regardless of the "refinements of title."[80] A taxpayer that receives money without "substantial limitations or restrictions" is taxable, even though the taxpayer's rights continue to be disputed.[81] Even embezzled amounts to which the taxpayer has no right at all are subject to inclusion.[82] The members of the Wellshire group were the tax owners of the property transferred, rightfully or not, and therefore the transferors. Moreover, the regulations made clear that QSF status did not depend on transferors' being able to get deductions.

The court further rejected arguments that the receivership estate did not meet other aspects of the regulations' test for QSF status. The taxpayers argued that the exclusion of obligations to refund, repair, or replace in connection with "products regularly sold in the ordinary course of the transferor's trade or business" meant that the transferors' potential liabilities under securities laws were not allowable claims. The court however held that "products" generally referred to tangible personal property and thus the exclusionary language did not apply to liabilities relating to intangibles such as securities. In the petition for rehearing, the taxpayers suggested that securities should be considered tangible property if they were represented by certificates, but the court concluded that the asserted distinction was meaningless.

Finally, the court also held that the potential securities liabilities did not fall under the exclusion for liabilities to "general trade creditors" and "debtholders" in a bankruptcy or similar insolvency case. The court noted that the preamble to the regulations specifically noted that the exclusion covered only general liabilities to creditors and that QSF treatment remained available "for other liabilities such as tort liabilities irrespective of whether the liability . . . relates to [an insolvency] case."[83]

Validity of the Regulations

The taxpayers' broadest argument, which the district court had not found necessary to reach, was that the QSF regulations were invalid because they "sweep more broadly in imposing tax than the carefully crafted statute and that they completely subsume, and thus render nugatory" the "carefully crafted" statutory DSF rules and the accompanying election.[84] Before the appellate court, the taxpayers added for good measure that the section 468B(g) was an unconstitutional delegation of Congress' authority and conflicted with the U.S.-German tax treaty. The Tenth Circuit made relatively short work of these issues, concluding that the regulations were validly issued pursuant to a specific grant of statutory authority, and the treaty was irrelevant because the fund was a U.S. taxpayer not entitled to treaty benefits. The end result was that the IRS' claim against the receivership estate was upheld.

Brown is significant because it seems to be both the first case in which QSF status was the central issue and the first deliberative reading of the regulations by an

appellate court. Besides adding its gloss to the regulatory language, the Tenth Circuit squarely upheld the regulations' expansion of the DSF regime and effective elimination of the statutory election. *Brown* drives home that a QSF can be created even though the parties — and even the supervising court — have no idea that they are creating one.[85] QSF status can have its benefits. Custodians are likely to find it easier to file a QSF return than to struggle to attribute and report income to members of a large class, even if their individual interests are theoretically determinable. Transferors can avoid reporting income from property they have effectively given up, and can generally get a deduction at the beginning of the distribution process rather than at the end. However, parties to settlement arrangements have to be aware of the circumstances under which a QSF can be created and the responsibility for the resulting tax.

1 334 F.3d 1197 (10th Cir. 2003), rev'g 2001-2 U.S.T.C. ¶ 50,519.
2 Reg. § 301.7701-4(a) (arrangement generally treated as a trust if its purpose "is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility.")
3 Reg. § 301.7701-4(a).
4 Reg. § 301.7701-7 (mere agent is not a fiduciary); In re Alan Wood Steel Co., 7 B.R. 697, 81-1 U.S.T.C. ¶ 9122 (Bankr. E.D. Pa. 1980); see also, e.g., McRitchie v. Commissioner, 27 T.C. 65, 68-69 (1956) (reviewed).
5 Rev. Rul. 71-119, 1971-1 C.B. 163; Rev. Rul. 70-567, 1970-2 C.B. 133.
6 I.R.C. §§ 673, 677. In unusual circumstances, these provisions may be overridden by section 672(f) (in the case of non-U.S. grantors) or section 678 (if another person has current rights over the property).
7 E.g., Douglas v. Willcuts, 296 U.S. 59 (1935); Helvering v. Blumenthal, 296 U.S. 552 (1935).
8 Reg. § 1.677(a)-1(d) (income that "may be applied in discharge of a legal obligation of the grantor").
9 E.g., Anesthesia Service Medical Group, Inc. v. Commissioner, 85 T.C. 1031, 1055-56 (1985), aff'd, 825 F.2d 241 (9th Cir. 1987).
10 53 B.R. 859 (E.D. Va. 1985).
11 See also, e.g., Stockton v. United States, 335 F. Supp. 984 (C.D. Cal. 1971) (assignment for benefit of creditors treated as a trust); Gen. Couns. Mem. 35783 (Apr. 17, 1974), 1974 WL 35591.
12 503 U.S. 47 (1992).
13 I.R.C. §§ 1398, 1399. These provisions were inapplicable in Sonner. See 53 B.R. at 862.
14 See I.R.C. § 6012(b)(3).
15 See, e.g., Rev. Rul. 85-42, 1985-1 C.B. 36 (trust set up to provide for payment of a bond issue in an "in substance defeasance" transaction).
16 E.g., Douglas and Holywell, supra.
17 7 B.T.A. 1162 (1927), acq. VII-1 C.B. 27 (1928).
18 E.g., Bonham v. Commissioner, 89 F.2d 725 (8th Cir. 1937).
19 See, e.g., Kuehner v. Commissioner, 214 F.2d 437 (1st Cir. 1954); Rev. Rul. 72-256, 1972-1 C.B. 222.
20 Cf., e.g., Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd, 194 F.2d 541 (6th Cir. 1952).
21 See, e.g., Northern Trust Co. v. United States, 193 F.2d 127 (7th Cir. 1951), cert. denied, 343 U.S. 956 (1952).
22 Gale v. Commissioner, 83 T.C.M. 1270 (2002).
23 Cf. Commissioner v. Indianapolis Power Co., 493 U.S. 203 (1990).
24 108 T.C. 448, 480-86 (1997), aff'd on this issue, rev'd and rem'd on others, 184 F.3d 786 (8th Cir. 1999), discussed in J. Salles, "Tax Accounting," 1(2) Corp. Bus. Tax'n Monthly (Nov. 1999).
25 1963-2 C.B. 229.
26 Cf. Reg. § 1.83-3(e) (excluding "unfunded and unsecured obligations" from "property"); see also, e.g., Estate of Bell v. Commissioner, 60 T.C. 469 (1973) (private annuity secured by escrowed stock).
27 296 U.S. 59 (1935).
28 310 U.S. 80 (1940).
29 310 U.S. 69 (1940).
30 See Sonner, 53 B.R. at 865.
31 85 B.R. at 902.
32 E.g., Wiles v. Commissioner, 59 T.C. 289 (1972), aff'd without published opinion, 491 F.2d 1406 (5th Cir. 1974).
33 I.R.C. § 682, 7701(a)(17).
34 See, e.g., Fuller, 310 U.S. at 74.
35 McRitchie v. Commissioner, 27 T.C. 65 (1956) (reviewed); Rev. Rul. 70-567, 1970-2 C.B. 133.
36 366 U.S. 380 (1961).
37 Dixie Pine Products Co. v. Commissioner, 320 U.S. 516 (1944).
38 Reg. § 1.461-2(c)(1).
39 Reg. § 1.461-2(f).
40 See, e.g., PLR 200019006 (Feb. 3, 2000), discussed in J. Salles, "Tax Accounting," 1(11) Corp. Bus. Tax'n Monthly 26, 29-31 (Aug. 2000).
41 See generally I.R.C. § 461(h).
42 I.R.C. § 461(h)(2)(C).
43 Reg. § 1.461-4(g), effective in 1992. See Reg. § 1.461-4(k)(3).
44 Reg. § 1.461-4(g)(1)(ii).
45 Pub. L. No. 99-514, § 1807(a)(7), amending Pub. L. No. 98-369, § 91; effective date provision is at Pub. L. No. 99-514, § 1881.
46 S. Rep. No. 99-313 at 925 (1986).
47 I.R.C. § 468B(a), (f).
48 I.R.C. § 468B(d).
49 I.R.C. § 468B(e).
50 TRA86, Pub. L. No. 99-514, § 1807(a)(7)(D).
51 Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 1018(f)(5).
52 H.R. Rep. 99-841, vol. II, at 844-45 (1986).
53 H.R. Report 100-391 at 1497 (1987). Essentially identical language appears at S. Rep. No. 100-445 at 398 (1988).
54 Reg. § 1.468B-1(c)(1).
55 Reg. § 1.468B-1(k) (Ex.. (2)).
56 Reg. § 1.468B-1(e).
57 42 U.S.C. § 9601 et seq.
58 Reg. § 1.468B-1(f)(1).
59 Reg. § 1.468B-1(c)(2), (f), (g).
60 Reg. § 1.468B-1(h)(2).
61 T.D. 8459, preamble, 1993-1 C.B. 68, 69.
62 Reg. § 1.468B-1(c)(3), (h)(1).
63 T.D. 8459, 1993-1 C.B. at 70.
64 Reg. § 1.468B-2.
65 I.R.C. § 461(h); Reg. § 1.461-4(d).
66 See Reg. § 1.461-1(a)(2)(iii), -4(e), (f).
67 Reg. § 1.461-4(g).
68 I.R.C. § 468B(a), (f); Reg. § 1.461-6(b).
69 Reg. § 1.468B-3(c)(3).
70 Reg. § 1.468B-3(c)(2).
71 Reg. § 1.468B-3(a)(1).
72 See generally I.R.C. § 111; Hillsboro National Bank v. Commissioner, 460 U.S. 370 (1983).
73 Reg. § 1.468B-3(f).
74 Reg. § 1.468B-1(k) (Ex. (6)).
75 Prop. Reg. § 1.468B-1(k).
76 Prop. Reg. § 1.468B-5(c)(1).
77 See also Rev. Rul. 92-51, 1992-2 C.B. 102.
78 Prop. Reg. § 1.468B-9, REG-209613-93, 64 Fed. Reg. 4801, 4810 (Feb. 1, 1999).
79 334 F.3d 1197 (10th Cir. 2003), rev'g 2001-2 U.S.T.C. ¶ 50,519 (D. Utah 2001).
80 Corliss v. Bowers, 281 U.S. 376, 378 (1930).
81 Burnet v. North American Oil Consolidated, 286 U.S. 417 (1932).
82 James v. United States, 366 U.S. 213 (1961).
83 T.D. 8459, 1993-1 C.B. 68, 69.
84 2001-2 U.S.T.C. ¶ 50,519 at _____.
85 See also, e.g., O'Cheskey v. United States, 2002-1 U.S.T.C. ¶ 50,197 (N.D. Texas 2001).