200534026

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

JUN - 1 2005

UICs: 408.00-00
408.03-00

LEGEND:

Taxpayer A =

Taxpayer B =

Company C =

Company D = .

Company E =

Bank F =

Association G =

Matter in Arbitration =

Company V =

Individual D =

Individual E =

Attorney F =

Law Firm H =

State S =

IRA X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

Month 1 =

Month 2 =

Month 3 =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Amount 5 =

Amount 6 =

Amount 7 =

Amount 8 =

Amount 9 =

Amount 10 =

Amount 11 =

Percentage 1 =

Dear

This is in response to a ruling request dated s supplemented by correspondence dated concerning the status of contributions to your individual retirement accounts (IRAs).

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

Taxpayer A is married to Taxpayer B. Taxpayers A and B are residents of State S. In 1999, Taxpayer A terminated employment with Company V 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.

On or about Date 1, 1999, Taxpayer A opened two accounts with Company C, a firm which is a member of Association G. One of the accounts was a joint account in the names of Taxpayers A and B which was funded with their savings in the amount of Amount 1. The second account was an individual retirement account ("IRA") set up and maintained in the name of Taxpayer A, described in section 408(a) of the Internal Revenue Code ("Code"), and funded with amounts received from the qualified retirement plan(s) maintained by Company V totaling Amount 2. Amounts 1 and 2 totaled Amount 10. Individual D, employed as a financial advisor with Company C, managed Taxpayer A's Company C IRA. As of Month 1, 2000, the value of Taxpayer A's IRA held with Company C had decreased significantly (by approximately Amount 3).

During Month 2, 2001, Taxpayer A transferred, by means of a trustee to trustee transfer, the amount remaining in his Company C IRA to another IRA set up and maintained in the name of Taxpayer A, described in section 408(a) of the Internal Revenue Code, with Company D, a firm which is a member of Association G. Individual E, employed as a financial advisor with Company D, managed Taxpayer A's Company D IRA. As of Month 3, 2002, the value of Taxpayer A's IRA held with Company D had decreased significantly (by approximately Amount 4).

On or about Date 2, 2002, Taxpayer A transferred, by means of a trustee to trustee transfer, the amount remaining in his Company D IRA to another IRA set up and maintained in the name of Taxpayer A, described in section 408(a) of the Internal Revenue Code, with Bank F.

On or about Date 3, 2003, Taxpayers A and B, instituted an Association G Arbitration proceeding against Company C and Company D ("Matter in Arbitration").

The Matter in Arbitration alleges that Individual D was employed as a financial advisor by Company C. It also alleges that Individual E was employed as a financial advisor by Company D.

The Matter in Arbitration contains a factual allegation to the effect that Company C, through Individual D, advised Taxpayers A and B to invest their funds, including Taxpayer A's IRA, contrary to their "...stated investment objectives and risk tolerance". The Matter in Arbitration also alleges that Company D, through Individual E, although aware that Taxpayers A and B were "...looking for a more conservative investment approach so as to protect the remainder of their life savings...", failed to invest their funds accordingly, but, instead, invested "...in a savings portfolio which was 95% comprised of equities and had no fixed income securities...".

Based on the above allegations and other allegations contained in the Matter in Arbitration, Taxpayers A and B alleged that the actions of Companies C and D constituted: (1) negligent misrepresentation and omission; (2) breach(es) of contract; (3) negligence; and (4) violations of State S securities law. Furthermore, the actions of Companies C and D were the proximate cause(s) of the losses suffered by Taxpayers A and B with respect to the investments (the losses referenced above-in Amounts 3 and 4).

Taxpayers A and B were represented by Attorney F, licensed to practice law in State S.

On or about Date 4, 2004, and Date 5, 2004, Taxpayers A and B entered into settlement agreement(s) with Companies C and D. In one agreement, Company E, the successor in interest to Company C, agreed to pay Taxpayers A and B Amount 5 in exchange for Taxpayers A and B dismissing, with prejudice, their claim against Company E. In the second settlement agreement, Company D agreed to pay Taxpayers A and B Amount 6 in exchange for Taxpayers A and B dismissing, with prejudice, their claim against Company D.

Amount 5 and Amount 6 totaled Amount 11.

From documentation contained in the file, it appears that the above-referenced settlement(s) were the result of "arm's-length negotiations" between various parties with adverse interests, and your authorized representative has asserted, on your behalf, that they were.

Pursuant to the settlement agreement, the Date 3, 2003 Matter in Arbitration against Companies C (now Company E) and D was dismissed.

Pursuant to the provisions of the settlement agreement reached between Taxpayers A and B and Company E, on or about Date 6, 2004, a check in the amount of Amount 5 was sent by Company E to Law Firm H, the law firm with which Attorney F was associated. On or about Date 7, 2004, said check was deposited into a Law Firm H trust account.

Pursuant to the provisions of the settlement agreement reached between Taxpayers A and B and Company D, on or about Date 8, 2004, a check in the amount of Amount 6 was sent by Company D to Law Firm H, the law firm with which Attorney F was associated. On or about Date 7, 2004, said check was deposited into a Law Firm H trust account.

The settlement agreements did not specify the portions of Amounts 5 and 6 that represented Taxpayer A's IRA losses.

On or about Date 9, 2004, Taxpayers A and B's counsel issued and delivered to said taxpayers two separate checks totaling Amount 7 which reflected the sum of the settlement proceeds paid by

Companies C and E less attorneys fees and expenses associated with the Matter in Arbitration and related settlement(s). One check totaled Amount 8, and was payable to Taxpayers A and B (jointly). The second check was in the amount of Amount 9, and was made payable to IRA X, an IRA in the name of Taxpayer A. On or about Date 10, 2004, Taxpayer A delivered said second check (the Amount 9 check) to Bank F to be placed into his IRA.

Date 10, 2004 occurred approximately 10 days after Date 9, 2004.

Date 10, 2004, occurred within 60 days of both Date 6, 2004 and Date 8, 2004.

It is represented that Amount 9 represents approximately Percentage 1 of Amount 7. Said Percentage 1 was intended to equal, or at least approximate, the percentage of losses incurred in Taxpayer A's IRA accounts held in Companies C (now Company E) and Company E as compared to the total losses suffered by Taxpayers A and B during the time Company C (now Company E) and Company D held their accounts (both IRA and non-IRA accounts).

Based upon the foregoing, you request the following rulings:

(1) That, for purposes of determining how much, if any, of Amount 7 received as settlement proceeds by Taxpayer A, should be treated as representing IRA losses incurred by Taxpayer A, said Amount 7 should be allocated between Taxpayer A's IRA and non-IRA accounts in proportion to the loss(es) incurred in each account;

and

(2) That Taxpayer A's receipt of Amount 9 pursuant to the above described settlement(s) of arbitration proceeding(s), and its subsequent contribution into an IRA set up and maintained in his name with Bank F, constituted 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 rulings, 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 rulings, it has been represented that Taxpayers A and B initiated an arbitration action against Company C (now Company E) and Company D, relating to significant losses in value of various investments, including an IRA set up and maintained in the name of Taxpayer A. The arbitration action alleged various causes of said losses of value relating to activities taken either by Company C (now Company E), Company D, or other named parties allegedly acting as the Agents of said Companies. Said arbitration action was settled "in good faith". Pursuant to said settlement, Taxpayers A and B recovered, after attorney's fees were deducted, Amount 7 which represented losses suffered in both Taxpayer A's IRA and in non-IRA property held jointly by Taxpayers A and B. Amount 9 was rolled over into an IRA described in Code section 408(a) set up and maintained in the name of Taxpayer A within 60-days of the date Taxpayers A and B received Amount 7.

In this case, the Service has noted that Amount 1 (non-IRA monies) and Amount 2 (IRA monies) totaled Amount 10. The Service also notes that Amount 2 is approximately (slightly more) than Percentage 1 of Amount 10. Furthermore, Amount 9 (the amount rolled over into Taxpayer A's IRA) is approximately Percentage 1 of Amount 7 (the full recovery under the settlement agreements).

The above reference settlement proceeds were designed to replace a portion of Taxpayers A and B losses (IRA and non-IRA) due to alleged misconduct on the part of the above named respondents. Additionally, in this case, the Service notes that no distribution occurred until the issuance of checks in Amount 5 and Amount 6 by Company E (successor in interest to Company C) and Company D, respectively.

In this case, as indicated above, the Service notes that the settlement agreement(s) did not specify which portion(s) of Amounts 5 and 6 were allocable to Taxpayer A's IRA losses. In the absence of such specification, the Service concludes that it is appropriate to allocate a pro-rata portion of Amount 7 (Amount 9 which is approximately Percentage 1 of Amount 7) to said IRA losses.

Accordingly, based on the particular facts and circumstances presented herein, we hold that Taxpayer A's receipt of Amount 9 from Companies E and D as the replacement of a portion of his original IRA, pursuant to the above-reference arbitration action settlements, and the payment of this amount to the newly-established individual retirement account, IRA X, at Bank F, represented a valid rollover.

Thus, with respect to your ruling requests, we conclude as follows:

(1). That, for purposes of determining how much, if any, of Amount 7 received as settlement proceeds by Taxpayer A, should be treated as representing IRA losses incurred by Taxpayer A, said Amount 7 should be allocated between Taxpayer A's IRA and non-IRA accounts in proportion to the loss(es) incurred in each account;

and

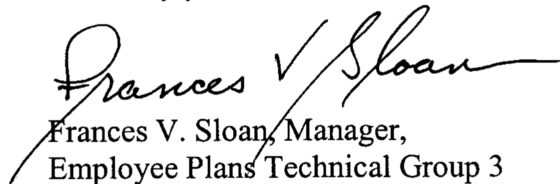
(2) That Taxpayer A's receipt of Amount 9 pursuant to the above described settlement(s) of arbitration proceeding(s), and its subsequent contribution into an IRA set up and maintained in his name with Bank F constituted a valid rollover transaction within the meaning of section 408(d)(3)(A)(i) of the Internal Revenue Code.

This ruling letter is based on the assumption that all of Taxpayer A's IRAs were described in Code section 408(a) as represented. It also assumes that the contributory IRA set up and maintained in the name of Taxpayer A with Bank F, 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 (ID:) 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