

ARIZONA DEPARTMENT OF REVENUE

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DIRECTOR

ARIZONA GENERAL TAX RULING **GTR 94-3**

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Must designated settlement funds pay Arizona income tax?

APPLICABLE LAW:

Arizona Revised Statutes (A.R.S.) § 43-102.A establishes the intent of the legislature to adopt the provisions of the Internal Revenue Code relating to the measurement of taxable income for corporations, estates, partnerships, and trusts to the end that the taxable income of these entities reported to the Internal Revenue Service and the department should be identical.

Internal Revenue Code (I.R.C.) § 468B(d)(2) defines a designated settlement fund (DSF).

I.R.C. § 468B(b) imposes on the gross income of any DSF a tax rate equal to the maximum rate in effect for trusts and permits the gross income of a DSF to be reduced by the amount of any administrative costs or other incidental expenses which would be deductible for purposes of determining the taxable income of a corporation.

DISCUSSION:

I.R.C. § 468B(d)(2) defines a "designated settlement fund" as a fund established by court order for the principal purpose of resolving and satisfying present and future claims against the defendant arising out of personal injury, death, or property damage and which extinguishes completely the defendant's tort liability with respect to those claims. The payments made into the fund are often held for a period of time before final settlement and distribution to the claimants. During this period, the monies are usually invested. For federal purposes, the income resulting from the investment is taxed at a rate equal to the maximum rate then in effect for a trust. However, the tax is imposed on the fund as a DSF under I.R.C. § 468B(b), and not as a corporation or trust.

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Pursuant to A.R.S. § 43-102.A, the intent of the legislature is to adopt provisions of the Internal Revenue Code related to *measurement* of income. However, this subsection does not adopt the Internal Revenue Code provisions relating to the *imposition* of an income tax. In addition, it delineates those taxable entities to which it applies.

There is no authority in Arizona's income tax provisions similar to I.R.C. § 468B which would impose a tax upon DSF income.

Arizona could only assert jurisdiction to tax a DSF by defining it as a trust or corporation for Arizona income tax purposes. However, such an interpretation would be inconsistent with the general conformity requirement of A.R.S. § 43-102.A since use of the DSF provisions by the Internal Revenue Service would result in the DSF being taxed in one manner for federal income tax purposes and use of the trust or corporate provisions by the department would result in the DSF being taxed in a different manner for purposes of the Arizona income tax.

RULING:

The income of a designated settlement fund is not subject to Arizona income tax.

Harold Scott, Director

Signed: April 14, 1994

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling.** See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.