



STATE OF MICHIGAN
DEPARTMENT OF TREASURY
LANSING

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LETTER RULING 2017-2

LR 2017-2. Taxability of a qualified settlement fund under the Michigan Corporate Income Tax Act.

You ask whether a qualified settlement fund as defined in IRC 468B(g) is subject to the Corporate Income Tax under Part 2 of the Michigan Income Tax Act¹ (MITA).

The taxpayer you inquire about is an escrow account that was established at a bank headquartered out-of-state as a result of the resolution of a class-action lawsuit pending in a federal court in Michigan and that was to be administered under the court's continuing supervision and control. You state that the sole source of income generated by the funds deposited in the escrow account is interest on investments in U.S. Treasury obligations. You also state that another out-of-state firm was retained to oversee disbursement of the escrow account to class members and to attend to other administrative duties. Finally, you state that the escrow account is a qualified settlement fund (QSF) as defined in IRC 468B(g) and the Treasury regulations promulgated under that provision.²

According to the IRC and federal regulations, an escrow account is a QSF if it satisfies certain conditions which you state are present in this case. An account that satisfies the statutory criteria is considered a qualified settlement fund for all purposes under the IRC even if it could otherwise be classified as a trust or association.³ The IRC treats the QSF as a corporation for purposes of all administrative and procedural rules of the Code, including return filing requirements,⁴ but the tax rate applied to its modified gross income once computed is the rate applied to estates and trusts.⁵

The corporate income tax is levied on corporations, insurance companies and financial institutions which are defined as corporations;⁶ a corporation is defined as a person that is required or has elected to file as a C corporation as defined under IRC 1361(a)(2) and 7701(a)(3).⁷ The IRC defines a corporation to include associations, joint-stock companies, and

¹ MCL 206.601-699.

² See IRC 468B(g) and Treas Reg 1.468B-1(a) and (c).

³ See Treas Reg 1.468B-1(b).

⁴ Treas Reg 1.468B-2(k).

⁵ Treas Reg 1.468B-2(a).

⁶ There are no facts represented to indicate that the taxpayer is an insurance company or a financial institution and this ruling therefore does not address those types of taxpayers.

⁷ MCL 206.605(1).

insurance companies but does not include S corporations.⁸ Since the QSF you inquire about is not a joint-stock company or an insurance company, its status as a taxpayer under the corporate income tax turns on whether it is an association.

Treasury regulations interpreting IRC 7701 determine the classification of an organization recognized as a separate entity unless another provision of the IRC provides for special treatment of that organization.⁹ IRC 468B provides for special federal income tax treatment for a QSF. Because a QSF is subject to special tax treatment under the IRC, it is not subject to classification under the Treas. Reg. 301.7701, and is therefore not an association under IRC 7701(a)(3). Because the QSF you inquire about is not an association under IRC 7701(a)(3), it is not a corporation under MCL 206.605(1) and not subject to the corporate income tax.

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⁸ See IRC 7701(a)(3). There is no indication in the request for ruling that the involved escrow account elected S corporation status and therefore, the definition in IRC 1361(a)(2) is not relevant to this ruling.

⁹ See Treas Reg 301.7701-1(b). Regulations governing entity classification include 301.7701-2, 301.7701-3 [the check-the-box regulation], and 301.7701-4.