INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Taxpayer's Name:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Amount $a	=
Amount $b	=
Amount $c	=

x% =

ISSUE:

Whether certain insurance settlement payments received by Taxpayer under third-party Commercial General Liability ("CGL") policies are monies received due to an involuntary conversion within the meaning of I.R.C. § 1033(a)(2)?

CONCLUSION:

Insurance settlement payments received by Taxpayer under third-party Commercial General Liability ("CGL") policies are monies received for indemnification with respect to tort liability and are not monies received due to an involuntary conversion within the meaning of I.R.C. § 1033(a)(2).

FACTS:

Taxpayer became liable, in part or in whole, for the remediation of environmental contamination that occurred at various Taxpayer operating sites through the years. These sites include properties that were no longer owned or operated by Taxpayer by Year 2. Taxpayer acknowledged that, with respect to these liabilities, federal, state and local environmental laws required Taxpayer to assume liability for remediation of its and others environmental contamination. These environmental laws included the following: the Clean Water Act; the Comprehensive Environmental Response, Compensation, and Liability Act ("CERCLA"); the Resource Conservation and Recovery Act ("RCRA"); and the Clean Air Act.

In response to these liabilities, Taxpayer either performed the clean-up activities itself or contributed funds to pay for clean-up activities. The remediation costs, which totaled hundreds of millions of dollars, included costs incurred for excavation, drilling, construction, soil and water treatment, and monitoring. Other remediation costs included those costs incurred by regulatory agencies; costs incurred to provide alternate drinking water supplies for affected community residents; costs incurred for technical studies; and costs for management, professional, and legal services.

Insurance Policies

In Year 1, Taxpayer filed claims with numerous insurance carriers to recover various costs and expenses associated with its environmental liabilities. The policies under which the claims were filed were CGL policies, which generally cover an insured's liability to third parties for torts committed by the insured.[1] Taxpayer contends that although it asserted claims under CGL policies, and although such policies ordinarily cover liabilities to third parties, Taxpayer nevertheless did not submit any third-party liability claims. Taxpayer contends that it solely asserted claims for costs to remediate the contamination of its own property.

All of Taxpayer's CGL policies that the Service reviewed provided for Coverage A (bodily injury) and Coverage B (property damage) to third parties. The language included some form of the following:

> The company will pay on behalf of the insured all sums which the insured shall become legally obligated to pay as damages because of A. bodily injury or B. property damage to which this insurance applies.

The reviewed policies also addressed exclusions, which set out those damages and/or events that would not be covered. The language included some form of the following:

> This insurance does not apply to property damage to:
>
> > (1) property owned or occupied by or rented to the insured,
> >
> > (2) property used by the insured, or
> >
> > (3) property in the care, custody or control of the insured or as to which the insured is for any purpose exercising physical control.

About half of the policies at issue contained an exclusion for taxpayer-owned property.

Following a review of the insurance policies, the Service found that none of the policies provided coverage for property damage to Taxpayer's properties or state that the

[1] Taxpayer did not file any claims under its first party insurance policies (e.g., fire and casualty insurance intended to protect an insured in case of certain occurrences) because those policies, as Taxpayer noted, did not cover land and the damage to land.

insurer would pay Taxpayer to repair property damage to Taxpayer's properties.

Taxpayer disputes the Service's finding that the insurance policies in question do not provide coverage for property damage to Taxpayer's properties, or state that the insurer would not pay Taxpayer to repair property damage to Taxpayer's properties. Taxpayer claims that while such policies may not expressly provide such coverage, Taxpayer nevertheless did in fact assert and settle claims against its insurers for property damage to Taxpayer's property.

Settlement Claims Report

Taxpayer prepared and provided an Environmental Claims Settlement Report ("Settlement Claims Report") to each of its insurance carriers. Taxpayer submitted the Settlement Claims Report to each insurer based upon its determination as to which policies would apply to its claims. The Settlement Claims Report presented the estimate of historic and future "Recoverable Costs" necessary to remedy, in compliance with applicable regulations, environmental conditions at selected North American sites owned and/or operated by Taxpayer and its current or predecessor entities.

In spite of Taxpayer's agreement that its CGL policies failed to provide express coverage for property damage to its properties, Taxpayer maintains that in its negotiations with the insurance companies, it asserted and settled claims against its insurers for property damage to its properties, filed claims for costs to remediate the contamination of its own properties, and submitted no third-party liability claims. Taxpayer asserts that, consistent with its theory of recovery, Recoverable Costs claimed by Taxpayer did not include existing and potential private party damage claims or suits, natural resource damage claims or asbestos, products liability and other non-environmental exposure.

Taxpayer's Settlement Claims Report and associated negotiation documents included, in part, Taxpayer's estimates of what costs would need to be expended in order to perform remedial activities on its properties. Taxpayer has represented that the Settlement Claims Report is not necessarily the actual remedial plans for the affected sites, nor are the projected costs the actual costs for remediation at those sites. Rather, Taxpayer contends that the Settlement Claims Report represents a conceptual method and cost for the remediation. In preparing its Settlement Claims Report, Taxpayer defined which costs would be potentially recoverable under its insurance programs. Expenditures were considered recoverable under Taxpayer's insurance programs if with respect to such costs:

> Taxpayer has or will likely incur such costs in connection with environmental conditions that cause(d) actual damage to or pose a substantial threat to third parties, offsite properties, and/or groundwater; and
>
> Taxpayer will likely be compelled to incur such costs for investigation, defense and/or remediation of the environmental conditions pursuant to and/or consistent

with an order or regulation from the U.S. EPA or applicable state, local or other regulatory environmental authority, or in response to a claim or lawsuit from a third party.

Underscoring its potential liability to others in its Settlement Claims Report, Taxpayer stated that the section "addresses only a fraction of the several thousand production sites where Taxpayer has or may have potential liability."

The Settlement Claims Report also contained the following information on each site: background; dates of operation; investigations and clean-up performed to date; basis for any future remedial actions and clean-up requirements; contaminants at site; volume of affected media and clean-up approach; and cost and information sources.

Settlement agreements were reached with various insurance companies beginning in Year 1. The settlement amounts accepted by Taxpayer were less than x% of the amount of claims made by Taxpayer to its insurers.

In the settlement documents executed by Taxpayer and the insurers, the insurers denied any liability for the submitted claims. Most of the settlement agreements included the following provisions:

1. The amount and time of payment of the settlement amount to Taxpayer;
2. A release by Taxpayer of the insurance company for any (unless excepted) and all liability arising out of obligations to indemnify or defend Taxpayer in connection with environmental claims under the tendered policies; and
3. A statement that the agreement, payments and releases represented a compromise of a disputed claim and should not be construed as an admission for any purposes on the part of the insured or insurer, other than necessary to enforce the terms of the agreement.

The insurance companies consistently denied any responsibility for coverage of remediation liabilities.

For taxable years Year 2, Year 3, and Year 4, Taxpayer reported receipts of insurance settlement proceeds amounting to Amount $a, Amount $b, and Amount $c, respectively. Taxpayer claims that while some of the proceeds it received from its insurers were attributable to damage at sites never owned by Taxpayer, such amounts were treated as ordinary income by Taxpayer and thus are not at issue in this case. The documents submitted with this case, including the settlement documents executed by Taxpayer and its insurers, however, make no allocation of the proceeds between Taxpayer owned and non-owned sites.

Taxpayer admits that a portion of the Amount $a, Amount $b, and Amount $c amounts is attributable to sites owned by the Taxpayer at some point but not owned by Taxpayer in the years at issue. Unlike the amounts attributable to sites never owned by Taxpayer, the amounts attributable to the formerly owned sites were treated by Taxpayer as consideration for damages to Taxpayer-owned property.

Taxpayer treated a portion of the Amount $a, Amount $b, and Amount $c payments as amounts received due to an involuntary conversion within the meaning of § 1033(a). The settlements reached between Taxpayer and the insurance companies for taxable years Year 2, Year 3, and Year 4 were submitted for review during audit.

For purposes of determining whether the insurance proceeds received by Taxpayer were intended to compensate Taxpayer for damage to its property, we are referring to the damage to Taxpayer's property as an involuntary conversion within the meaning of § 1033(a). We express no opinion, however, as to whether this damage constitutes an involuntary conversion of property within the meaning of § 1033, or whether any other requirements under the statute have been met.

LAW AND ANALYSIS:

Section 1033(a)(2)(A) of the Code provides, in general, that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition, or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money, and if the taxpayer, during the time specified in § 1033(a)(2)(B), purchases property similar or related in service or use to the property so converted, at the election of the taxpayer, the gain shall be recognized only to the extent the amount realized on such conversion exceeds the cost of such other property.

The underlying purpose of § 1033 is to allow a taxpayer to postpone recognition of gain arising from a realization event outside of the taxpayer's control if the taxpayer maintains a continuity of investment in substantially similar property. However, § 1033 does not afford nonrecognition of all gains. Rather, only gains from the *conversion of property* are entitled to nonrecognition treatment under § 1033. Thus, in the present case, the insurance proceeds received by Taxpayer are subject to nonrecognition under § 1033 only if the proceeds represent "compensation for the involuntary conversion of the taxpayer's property." Allen v. Commissioner, T.C. Memo. 1998-406, 76 T.C.M. 852 (1998).

The Service and the courts use the origin of the claim doctrine to determine whether insurance proceeds represent compensation for a taxpayer's involuntary conversion of property. Allen v. Commissioner, T.C. Memo. 1998-406, citing Bagley v. Commissioner, 105 T.C. 396, 406 (1995), aff'd, 121 F.3d 393 (8th Cir. 1997). In determining the nature of the claim and thus the taxability of the proceeds, the most important factor to consider is the intent of the payor, considering all the facts and circumstances. Allen, citing Knuckles v. Commissioner, 349 F.2d 610, 613 (10th Cir. 1965), aff'g. T.C. Memo 1964-33. The essential question in such a case is: What is "the basic reason for the . . . payment," Agar v. Commissioner, 290 F.2d 283 (2d Cir. 1961); or phrased differently, what was "the intent of the payor as to the purpose in making the payment," Knuckles, supra. As the Allen court stated, one looks to the language of the settlement agreement and considers the intent of the payor and all of the facts and circumstances. Although the belief of the payee is relevant to the inquiry, the character of the settlement payment hinges ultimately on the dominant reason of the payor in making that payment**.** Jacobs v. Commissioner, T.C. Memo 2000-59.

The determination of the nature of a claim is factual. Courts first look to the written terms of the settlement agreement to determine the origin and allocation of settlement proceeds. See Metzger v. Commissioner, 88 T.C. 834 (1987), aff'd. without published opinion, 845 F.2d 1013 (3d Cir. 1988). The origin of the claim may be determined by such agreement when it is entered into in an adversarial context, at arm's length, and in good faith.

In the present case, we explored numerous documents in deciding whether to accept Taxpayer's assertion that the intent of the insurance companies in making its payments to Taxpayer was to compensate Taxpayer for the involuntary conversion of Taxpayer's property. Those documents included the insurance policies, the settlement documents and negotiation documents executed by Taxpayer and its insurers, and the Settlement Claims Report submitted by Taxpayer to its insurers.

Terms of CGL Third-Party Insurance Policies

The insurance proceeds at issue were received by Taxpayer in connection with CGL policies. CGL policies provide indemnification for the insured against third-party lawsuits concerning certain kinds of damage sustained by the third party. A CGL insurance policy's grant of coverage section defines the scope of the third-party policy. It delineates the nature of the protection afforded and the circumstances under which payments will be made.

CGL insurance is referred to as "third-party" liability insurance because, unlike other insurance which is bought to protect the insured's life, health or property, liability insurance is purchased to protect the insured or policyholder against certain kinds of claims made by a third party. St. Joe Minerals Corp. v. Zurich Insurance Co., 75 Cal. App. 4th 261 (1999). First-party insurance policies cover an insured party for loss or injury to the insured's own property. First-party coverage for damage to the insured's own property is not the same as third-party liability insurance, which provides coverage for liabilities arising out of injuries to others. Garvey v. State Farm Fire & Casulaty Co., 770 P.2d 704 (Cal. 1989); Shell Oil v. Winterthur Swiss Insurance Co. et al., 12 Cal. App. 4th 715 (1993) (citing Garvey v. State Farm Fire & Casualty Co).

The primary coverage provided by a CGL policy is coverage for damage to a third party for which the insured is liable. All of the CGL policies reviewed by the Service in connection with this case contained language such as the following: "We will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies." Taxpayer acknowledges that its CGL insurance policies carried no express provision providing coverage for property damage to Taxpayer's own property.

Along with the language in the grant of coverage section indicating that the policies covered damages to third parties, approximately half of the reviewed policies provided explicit exclusions concerning Taxpayer's own property. The typical owned property exclusion in the policies at issue provides as follows: "This policy shall not apply . . . to injury or destruction of property owned by the Named Assured."

The language in the insurance policies thus suggests that the proceeds paid by the insurance companies did not represent compensation for the involuntary conversion of Taxpayer's property because such damage to Taxpayer's property was not covered under the terms of the policies. Rather, the language of the policies suggests that the insurance proceeds Taxpayer received under the terms of the CGL policies were to compensate Taxpayer for its liabilities to third parties. See Jasko v. Commissioner, 107 T.C. 30 (1996). In particular, the "legally obligated to pay as damages" language, as well as the owned-property exclusions in the policies, are inconsistent with Taxpayer's position that the insurance proceeds were intended to compensate Taxpayer for property damage to Taxpayer's own property.

In determining whether insurance proceeds paid by insurance carriers should be considered money received due to an involuntary conversion, courts have scrutinized the insurance policies under which the payments were made. Where it has been determined that insurance proceeds represented money from the conversion of the taxpayer's property, the insurance policies specifically provided coverage for property damage to the taxpayer's property. See Miller v. Hocking Glass Co., 80 F.2d 436 (6th Cir. 1935), cert. denied 298 U.S. 659; Marcal Pulp & Paper, Inc. v. Commissioner, 30 T.C. 1345, 1350 (1958), aff'd, 268 F.2d 739, cert. denied, 361 U.S. 924; Masillon-Cleveland-Akron Sign Co. v. Commissioner, 15 T.C. 79, 84-85 (1950); Shakertown Corp. v. Commissioner, 277 F.2d 625 (6th Cir. 1960); Maryland Shipbuilding and Drydock Co. v. United States, 409 F.2d 1363 (1969).

In Maryland, the taxpayer argued that a certain portion of money it received represented money from an involuntary conversion. The court held that it did not because "[w]hatever the conceptual appeal of such an approach to the problem as an original proposition, the argument is foreclosed by the express language of the policy." Maryland Shipbuilding and Drydock Co. v. United States, 409 F.2d 1363, 1365 (1969).

Taxpayer's policies provided for coverage only for sums payable when the insured becomes legally obligated to pay damages to a third party because of 'bodily injury' or 'property damage' to third parties. Nothing in the language of the policies suggests that the insurance proceeds Taxpayer received represent compensation for the involuntary conversion of Taxpayer's property.

Settlement Claims Report

In spite of Taxpayer's acknowledgment that its CGL insurance policies carried no express provision providing coverage for property damage to Taxpayer's own property, Taxpayer maintains that it asserted claims against its insurers for such property damage by filing claims for costs to remediate the contamination of Taxpayer-owned properties. Taxpayer further claims that it submitted no third-party liability claims. Thus, Taxpayer argues that because the insurers paid amounts for such claims, the origin of the proceeds is Taxpayer's property damage and such proceeds are monies received due to an involuntary conversion within the meaning of I.R.C. § 1033(a)(2).

In preparing its Settlement Claims Report, Taxpayer defined which costs would be potentially recoverable under its insurance programs and included in its report to insurers estimates of costs that would need to be expended in order to perform remedial activities on its properties. In addition to these remediation cost estimates, Taxpayer included information regarding expenses unrelated to the damage to Taxpayer's property (including existing third-party damages, damages to property formerly owned by Taxpayer, investigation costs, and pending lawsuits).

We do not agree that the proceeds paid by the insurer to Taxpayer were in consideration for Taxpayer's property damage. Taxpayer admits that a portion of the insurance proceeds it received was attributable to third-party sites never owned by Taxpayer. In addition, the costs relating to Taxpayer's recoverable costs (actual damage to or a substantial threat to third parties, offsite properties, and/or groundwater) are unrelated to damage to Taxpayer's property. While an insured may incur costs for remedial actions taken on its property, such costs are for the purpose of preventing the continuation of, or imminent damage to, third-party property. Without such third-party liability, the insured could not file a claim under its CGL policies for remediation costs. Thus, while the Settlement Claims Report included cost estimates for proposed remedial actions taken on Taxpayer's property, the purpose of including such cost estimates was to demonstrate the potential costs of complying with the environmental statutes that established Taxpayer's tort liability. The amount actually collected by Taxpayer from its insurers was less than x% of the amount claimed. Regardless of which costs were included in its claims to its insurers, it is apparent from the amount collected by Taxpayer that the insurance companies did not believe they were liable for costs to remediate environmental damage to Taxpayer's property.

In its Settlement Claims Report, Taxpayer prepared and submitted a document summarizing its claims by including the following statement: "[Taxpayer] has abided by a strict definition of remediation costs. [The Settlement Claims Report] includes only costs that: relate to environmental conditions that have caused damage or pose substantial threat to third parties, and compel investigation and remediation." With respect to third-party property damage, courts have consistently held that when a property owner has brought suit against the insured as a result of pollution, property damage has occurred to the third party's property[2]. The costs of measures taken on the insured's property to prevent continuing or imminent third-party damage qualify as costs covered under CGL coverage. Such costs are considered costs incurred to address the damage to the third-party property, not to address damage to the insured's property. Neither the insurance policies nor Taxpayer's Settlement Claims Report provided that the amounts paid to Taxpayer covered Taxpayer's property damage.

Settlement Agreement

The most important factor to consider in determining the taxability of settlement proceeds is the intent of the payor of such proceeds. Documents actually prepared by the insurers, or at least signed by the insurers, would likely provide the most accurate assessment of the insurers' motivation.

The settlement agreements executed by the insurers at issue do not identify the insurance proceeds as coming from a particular policy or relative to a particular site and

[2] United States v. Conservation Chem. Co., 653 F. Supp. 152 (W.D. Mo. 1986) (applying Missouri law); Lansco Inc. v. State Dept. of Envtl. Protection, 138 N.J. Super. 275, 350 A.2d 520 (Ch. Div. 1975), aff'd, 145 N.J. Super. 443, 368 A.2d 363 (App. Div. 1976), cert. denied, 73 N.J. 157, 372 A.2d 322 (1977); C.D. Spangler Constr. Co. v. Industrial Crankshaft & Eng'g Co., 326 N.C. 133, 388 S.E.2d 557 (1990); United Pac. Ins. Co. v. Van's Westlake Union, Inc., 34 Wash. App. 708, 664 P.2d 1262 (1983); Wagner v. Milwaukee Mut. Ins. Co., 145 Wis. 2d 609, 427 N.W.2d 854(1988).

do not specify the express purpose of the payment. In the settlement documents, virtually all of the insurers deny responsibility under the policies for the claims submitted by Taxpayer. All of the settlement agreements contain releases of the insurance companies for all past, present, and future liabilities relating to the environmental contamination. The releases, in substance, state as follows: “Taxpayer agrees to release insured from all past, present, and future liability for claims, actions, rights, liabilities, and demands for punitive or other legal, statutory or equitable relief under the policies regarding or arising out of any claims for remediation, bodily injury, property damage or natural resource damage (including pending and future litigation) due to the environmental contamination at Taxpayer sites.” In addition, all of the settlement agreements include an indemnification clause requiring Taxpayer to indemnify the insurer up to the amount of the settlement payment in the event an environmental claim is made against the insurer by a private or governmental party.

We believe it is reasonable to infer from the language in the release (especially based on the lack of reference to damage to Taxpayer property, the indemnification provisions, and the fact that the settlement amounts were a mere fraction of the claim submitted) that the insurance companies’ settlement payments were to compensate Taxpayer for third-party damage claims. Nothing in the settlement documents remotely suggests that the payments by the insurers to the Taxpayer represents amounts paid for the involuntary conversion of Taxpayer’s property.

In addition to the settlement agreements, we also reviewed negotiation documents consisting of correspondence between Taxpayer and its insurers relating to the claims that had been submitted by Taxpayer. We note that there are numerous references in the negotiation documents to lawsuits wherein large numbers of property owners are seeking damages arising from Taxpayer’s contamination, including property damages and personal injury damages. The references state that these and other similar lawsuits will expose Taxpayer to substantial future liability. As evidenced in the negotiation documents, the insurance companies, in deciding whether any amounts should be paid to Taxpayer, were concerned with whether a potential third-party claim, action, and/or suit existed. Thus, a far more logical reason than that offered by Taxpayer for the payments from the insurer to Taxpayer -- one more in keeping with the nature of Taxpayer’s CGL policies -- would be to compensate Taxpayer for its expenses in defending these lawsuits as well as any personal injury or property damages required to be paid by Taxpayer to third parties as a result of these lawsuits.

<u>E.R Hitchcock and Graphic Press</u>

The taxpayer correctly points out that § 1033 is a relief provision the purpose of which is "to aid the taxpayer where he in good faith quickly transforms everything he received into property 'similar or related in . . . use." Commissioner v. Babcock, 259 F.2d 689, 692 (9th Cir. 1958). As such, § 1033 requires a broad construction to effectuate its purpose. In illustrating § 1033's broad construction, the taxpayer pointed to the cases of E.R. Hitchcock v. U.S., 514 F.2d 484 (2nd Cir. 1975) and Graphic Press, Inc. v. Commissioner, 523 F.2d 585 (9th Cir. 1975). Taxpayer argues that similar treatment should be accorded the facts of the present case.

In E.R. Hitchcock, the taxpayer, following an involuntary conversion of its property, was awarded $130,000, $90,000 of which was compensation for its building and land and $40,000 of which was compensation for the relocation of its machinery and equipment. The taxpayer treated the entire condemnation award of $130,000, including the $40,000 reimbursement of its moving expenses, as qualifying for deferred recognition of gain under § 1033.

The Second Circuit agreed with the taxpayer's treatment of the condemnation award, including the portion attributable to moving expenses, noting that, "[e]conomically and substantively [citations omitted], this money received for moving expense was part of the 'amount realized' on the conversion. But for the conversion it would not have been realized. It was not just an integral part of the state award, it was to compensate the taxpayer for the property taken." 514 F.2d at 487.

In Graphic Press, the California Department of Public Works notified the taxpayer that the State of California intended to condemn the taxpayer's property for the purpose of widening the San Bernardino Freeway. The State condemned the taxpayer's land and building. Because the building included extensive machinery and equipment (fixtures), the condemnation order required the State to pay the taxpayer an amount equal to the fair market value of the fixtures unless the State could negotiate some relief from that obligation. Negotiations produced a settlement under which the taxpayer agreed to remove the fixtures and move them to the taxpayer's new location. Correspondingly, the State agreed to compensate the taxpayer for the expense of moving the fixtures.

The Commissioner argued that the portion of the condemnation award allocable to moving expenses was not a payment for the property taken. The Court disagreed with the Commissioner and held as follows:

> We believe compensation in excess of land and building payments in this case qualifies for section 1033 treatment. From the taxpayer's viewpoint, he is being compensated for a loss due to the condemnation of his

> property. Whatever payment the taxpayer receives is attributable to the involuntary conversion. Where, as here, a payment is made for relocation costs in addition to land and building costs, as long as the condemnee reinvests the total award into other property similar or related in service or use within the statutory period, both the language and spirit of the statute have been met. 523 F.2d at 589.

We are not persuaded that the result in these cases compels similar treatment of the insurance proceeds at issue in the present case. First, the Second Circuit in E.R. Hitchcock used a but-for standard in determining the applicability of § 1033, a standard the Ninth Circuit in Graphic Press refused to adopt. “We are not inclined to follow a *but for* test in all circumstances [because] a *but for* test might allow deferment of an award for lost profits . . , which should be currently taxed irrespective of reinvestment.” Graphic Press, 523 F.2d at 589. Further, in Graphic Press, the condemning authority had an obligation to pay the taxpayer an amount equal to the fair market value of its machinery and equipment. Such payment clearly would have been subject to the non-recognition provisions of § 1033. Because moving the machinery and equipment was more cost-effective, it was, at the condemning authority's expense, relocated to the taxpayer's new place of business. The payment to the taxpayer for its moving expenses, therefore, was a substitute for the payment that would have been made for the equipment's involuntary conversion and thus should be treated in the same manner as any payment for such conversion. No similar facts exist in the present case.

While the taxpayer cites E.R Hitchcock and Graphic Press in support of its case, we believe Kieselbach v. Commissioner, 317 U.S. 399 (1943) and Tiefenbrunn v. Commissioner, 74 T.C. 1566 (1980), which deal with payments of interest in connection with an involuntary conversion, are more analogous to the present facts.

In Kieselbach, property owned by a taxpayer was condemned by the City of New York. New York law provided that if full payment for the property was not made on the date of entry of the condemnation order, the amount paid to the property owner must include interest on the value of the property from the date of the taking until the date of payment. The taxpayer argued that the interest portion of the award was a part of the compensation for the condemned property, and thus should be accorded capital gain rather than ordinary income treatment. The Supreme Court disagreed with the taxpayer, stating that the interest was paid because of the City’s failure to put the award in the taxpayer's hands on the day the property was taken. Thus, the Court held that the amount was ordinary income interest, not a capital gain.

Tiefenbrunn v. Commissioner, 74 T.C. 1566 (1980), also addressed the treatment of interest, but specifically in the context of the manner in which § 1033 applies to the receipt of interest. In Tiefenbrunn, the Tax Court considered whether interest awarded a taxpayer pursuant to a judgment determining the amount of just compensation for the condemnation of the taxpayer's property must be included in income, or whether it is part of the gain on the involuntary conversion of the property entitled to nonrecognition under § 1033. The taxpayer argued that the interest on the value of the condemned property from the date of the taking until the date of payment is an essential element of the required just compensation for property taken by eminent domain. Thus, because the interest was a part of the just compensation for the converted property and would not have been received but for the involuntary conversion of the taxpayer's property, it was part of the gain on the conversion eligible for nonrecognition under § 1033.

In disagreeing with the taxpayer's position, the Court stated as follows:

> The principal difficulty with petitioners' arguments is the language of section 1033. Section 1033 provides nonrecognition treatment only for 'gain' from the involuntary conversion of 'property . . . into money.' The statute does not afford nonrecognition of all gains -- instead, it provides nonrecognition treatment only for gains from the conversion of *property. . . .* See Kieselbach v. Commissioner, 317 U.S. at 404. To be sure, the [taxpayer] would not have realized the interest income involved herein but for the condemnation of its property, but it would have received no interest income at all if full payment for the property had been made on the date of the condemnation. The delay in payment, not the condemnation, was the reason the [taxpayer] received the "interest." 74 T.C. at 1572-1573.

We believe Kieselbach and Tiefenbrunn are analogous to the present case. Here, Taxpayer would not have received insurance proceeds had its property not been converted. However, no insurance proceeds would have been forthcoming if there had been no damage or injury, or threat of damage or injury, to third parties. Had the taxpayer's properties been in a completely isolated area where the environmental damage to its property had no potential of causing injury to third parties or damage to third-party property, no insurance proceeds would have been paid. Thus, in the present case, the third-party damages, not the damage to the taxpayer's property, was the reason the taxpayer received the insurance payments.

As stated in Kieselbach and Tiefenbrunn, if the reason the taxpayer received the payment was other than the involuntary conversion, the amount is not part of the gain on the conversion. See also Rev. Rul. 73-477, 1973-2 C.B. 302, which holds that if an insurance contract insures against lost profits and fixed charges, the proceeds are ordinary income, and nonrecognition treatment under § 1033 is not available, notwithstanding that the amounts are payable in connection with an involuntary conversion.

CONCLUSION:

Taxpayer's CGL insurance policies carried no express provisions providing coverage for damage to Taxpayer's own property. The estimated costs to remediate insured's property in its Claims Report do not represent claims for coverage of property damage to Taxpayer's property. A review of the settlement agreements between the insurance companies and Taxpayer demonstrates that the intent of the parties was to indemnify Taxpayer against any claims with respect to any damage that Taxpayer caused, or potentially would cause, to third parties. Thus, the insurance settlement payments received by Taxpayer under its third-party CGL policies are monies received for indemnification with respect to tort liability and are not monies received due to an involuntary conversion within the meaning of I.R.C. § 1033(a)(2).

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.