Notice 2010-43

Johnson Regina

From: Thomas Symonds [symondstes@gmail.com]
Sent: Monday, May 10, 2010 3:33 PM
To: Notice Comments
Subject: Guidance in Notice 2010-43

MAY 11 2010
LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

I think the biggest problem the IRS must tackle in non-filers.

Thomas E Symonds Boise ID

LEGAL PROCESSING DIVISION
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Notice 2010-43

AUG 11 2010

AMERICAN GAMING ASSOCIATION

FRANK J. FAHRENKOPF, JR.
President & CEO

RECEIVED
2010 AUG 10 AM 8:51
INTERNAL REVENUE SERVICE

August 10, 2010

BY MESSENGER

Commissioner of Internal Revenue
Internal Revenue Service
Courier's Desk
Attn: CC:PA:LPD:PR
(Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: 2010-2011 Priority Guidance Plan (Notice 2010-43) -
Davis & Harman/National Thoroughbred Racing Association Submission to Treasury/IRS on Pari-Mutuel Tax Reporting/Withholding Issue

Dear Mr. Commissioner:

The American Gaming Association (AGA) is a nonprofit trade association that represents the commercial casino entertainment industry in addressing federal legislative and regulatory issues and other national matters of interest to the industry. AGA also serves as a clearinghouse for information, develops educational and advocacy programs, and provides industry leadership in addressing issues of public concern. AGA's casino members own or operate more than 150 gaming properties throughout the United States, employing hundreds of thousands of workers nationally, and accounting for approximately two-thirds of the country's commercial gaming revenue.

We are writing with respect to the Davis & Harman submission to the Internal Revenue Service requesting that the 2010-2011 Priority Guidance Plan include guidance making a change in the definition of "amount wagered" in determining pari-mutuel withholding and reporting for Federal tax purposes. The submission – which we understand to be made on behalf of the National Thoroughbred Racing Association – is in the form of a letter to IRS dated June 11, 2010 from the law firm of Davis & Harman LLP, accompanied by a "white paper" entitled "Request to Change Definition of 'Amount Wagered' in Determining Pari-Mutuel Withholding and Reporting". The submission was published in the August 5, 2010 issue of *Tax Notes Today.*

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202-552-2675 Fax 202-552-2676 www.americangaming.org

While this technical tax concern voiced by the pari-mutuel industry appears worthy enough to be pursued on its own merits, we are writing to take strong issue with the assertion in the Davis & Harman "white paper" that the casino gaming industry enjoys some undue competitive business advantage relative to the pari-mutuel industry arising out of an undue advantage in tax reporting and withholding obligations. This assertion is premised upon a series of factual inaccuracies in the Davis & Harman "white paper". Two other organizations, the Keeneland Association and the Harness Tracks of America – evidently working in coordination with Davis & Harman from the same template of talking points as the "white paper" – have written IRS repeating this factually inaccurate assertion. AGA is writing to correct the record.

The pari-mutuel industry's stated technical tax concern relates to the way in which the amount of a wager is calculated by the IRS for a pari-mutuel betting pool such as a trifecta. This appears to be an issue unique to the pari-mutuel industry. The nub of the pari-mutuel industry's concern, as we understand it, is that the IRS is significantly undercalculating the amount of the wager in the trifecta-type situation by giving the patron credit only for a $20 wager in determining net taxable winnings, when the actual dollar amount wagered in fact is $4,200 in the example in the "white paper".

After raising this technical tax concern unique to the pari-mutuel industry, however, the "white paper" then goes on to assert that the casino gaming industry enjoys some undue competitive business advantage relative to the pari-mutuel industry arising out of an undue advantage in tax reporting and withholding obligations. This assertion of undue advantage in tax reporting and withholding said to be enjoyed by the casino gaming industry is premised upon a series of factual inaccuracies in the "white paper".

The "white paper" begins with the assertion that "*[u]nlike all of its competitors in other gaming industries*, the pari-mutuel industry is burdened by an inequitable tax law that requires racetracks and other wagering facilities to withhold federal taxes on winnings over $5,000 if the odds are at least 300 times the 'amount wagered.' (*See* Section 3402(q)(3))." [emphasis added]. This premise is inaccurate. The casino gaming industry is indeed subject to this same rule on casino table games. *See* I.R.C. § 3402(q)(3)(A). The chart on p. 4 of the "white paper" contains similar factual flaws. In addition, the text on p. 4 further misstates the casino industry's tax reporting obligations by asserting that the pari-mutuel industry is forced with respect to payouts of over $5,000 to endure "the expenditure of thousands of man-hours processing IRS withholdings and producing Forms W-2G. Casinos are not subject to this requirement." On the contrary, casinos must endure the burden of a flood of Form W-2G reports required for slot machine payouts of $1,200 or more – a burden not only of administrative costs but also lost business revenue from the stoppage of play on the slot machine for a significant period while the machine is locked down and the W-2G report is being prepared.

AGA and the casino gaming industry have enjoyed a longstanding constructive working relationship with the IRS on tax information reporting, withholding and compliance matters, and we look forward to continuing this relationship into the future. We appreciate this opportunity on behalf of the casino gaming industry to correct the record here.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Frank J. Fahrenkopf
President & CEO

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

AUG 1 1 2010

PENN NATIONAL
GAMING, INC.

August 3, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Request to Include an Item on the 2010-2011 Guidance Priority List

Dear Messrs. Shulman and Wilkins:

Penn National Gaming, Inc. is writing to express our strong support for the request submitted on June 11, 2010, by Mr. Thomas A. Davis to include in the Guidance Priority List for 2010-2011 guidance changing the definition of "amount wagered" in determining pari-mutuel withholding and reporting. More specifically, the guidance would provide that, for purposes of withholding proceeds from pari-mutuel wagering pursuant to section 3402(q)(3) of the Code and reporting pursuant to Treas. Reg. section 31.3406(g)-2(d)(3), the "amount wagered" would include the total amount wagered by the recipient of the winning proceeds into the pari-mutuel pool from which such proceeds are paid. A copy of the request for inclusion in the Guidance Priority List is attached.

Penn National Gaming, Inc. is the largest operator of pari-mutuel racetracks in North America with ten (10) wholly-owned or joint venture facilities in eight (8) different jurisdictions. We also operate five (5) off-track wagering locations and a regional Telephone and Internet Account Wagering service. Total wagering through our pari-mutuel facilities is in excess of $1.5 billion dollars annually.

Over the past few years, wagering on pari-mutuel horse racing has declined dramatically, from $15.10 billion in 2003 to $12.3 billion in 2009. The pari-mutuel horse racing industry – representing nearly 1,000 off-track wagering service sites and some 200 racetracks – has lost market share as horseplayers migrate to other forms of gambling entertainment that do not withhold on winnings. The current rules are both inequitable and discriminatory in favor of other types of gambling. Changing the definition of "amount wagered" would address this inequity.

Thank you for your consideration of this request. If we may provide any additional information, or answer any questions, please feel free to contact me at any time at Christopher.mcerlean@pngamong.com or 717-460-8774.

Sincerely,

Christopher McErlean
Vice President – Racing
Penn National Gaming, Inc.

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
Notice 2010-43
AUG 9 2010

July 29, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Request to Include an Item on the 2010-2011 Guidance Priority List

Dear Messrs. Shulman and Wilkins:

Our organization is writing to express our strong support for the request submitted on June 11, 2010, by Mr. Thomas A. Davis to include in the Guidance Priority List for 2010-2011 guidance changing the definition of "amount wagered" in determining pari-mutuel withholding and reporting. More specifically, the guidance would provide that, for purposes of withholding proceeds from pari-mutuel wagering pursuant to section 3402(q)(3) of the Code and reporting pursuant to Treas. Reg. section 31.3406(g)-2(d)(3), the "amount wagered" would include the total amount wagered by the recipient of the winning proceeds into the pari-mutuel pool from which such proceeds are paid. A copy of the request for inclusion in the Guidance Priority List is attached.

The Thoroughbred Racing Associations (TRA) of North America, Inc., is a trade association of racetracks formed in 1942 to serve as a unified and unifying voice for racetrack owners and operators. The TRA currently represents 46 member associations conducting racing at 39 racetracks in the United States.

Over the past few years, wagering on pari-mutuel horse racing has declined dramatically, from $15.10 billion in 2003 to $12.3 billion in 2009. The pari-mutuel horse racing industry – representing nearly 1,000 off-track wagering service sites and some 200 racetracks – has lost market share as horseplayers migrate to other forms of gambling entertainment that do not withhold on winnings. The current rules are both inequitable and discriminatory in favor of other types of gambling. Changing the definition of "amount wagered" would address this inequity.

Approximately two-thirds of all U.S. pari-mutuel wagers are made into multi-horse (e.g. exacta, trifecta, superfecta) or multi-race (e.g. Pick-3, Pick-4, Pick-6) pools, so the preponderance of wagers into these pools are combination bets, multiple wagers covering a number of potential outcomes. Consequently, a bettor may place dozens, hundreds, or even thousands of combinations, improving his or her odds of winning but also guaranteeing all except possibly one of these combinations will lose. This type of wagering is necessary to provide a viable reward vs. risk proposition before bettors when a Pick-6 consisting of eight horses in each of the six races provides more than a quarter of a million possible outcomes.

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www.tra-online.com

These are the only type of wagers that trigger withholding under current regulations and the current definition of amount wagered utilizing a small portion of a bettor's investment in the pool discounts the accompanying losing wagers the IRS will permit to be deducted against the winnings on an annual income tax return. If not confiscatory and inequitable as viewed by U.S. bettors, the current definition of "amount wagered" seems at the very least inconsistent with the tax code.

Thank you for your consideration of this request. If we may provide any additional information, or answer any questions, please contact Christopher Scherf by telephone (410-392-9200, ext. 220) or by e-mail at cscherf@tra-online.com.

Sincerely,

Christopher N. Scherf
Executive Vice President

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

AUG 3 2010

AMERICAN BENEFITS COUNCIL

July 30, 2010

Filed via e-mail to Notice.Comments@irscounsel.treas.gov

Re: Notice 2010-43: Recommendations for 2010-2011 Guidance Priority List

Dear Sir or Madam:

The American Benefits Council (Council) is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans. The Council is writing to recommend items that should be included on the 2010-2011 Guidance Priority List, specifically items that pertain to employee benefits matters.

Partial Rollovers of After-Tax Amounts

The Council submitted two comment letters to the Internal Revenue Service, dated June 1, 2010 and October 26, 2009, requesting guidance on the tax treatment of a partial rollover to an IRA from a retirement plan that includes amounts attributable to after-tax employee contributions. There is no published guidance addressing the issue. However, in a newsletter published by the Service in March, 2010,[2] and in the updated 402(f) notice published in September, 2009,[3] the Service suggests that the "pre-tax first" rule of section 402(c)(2) of the Internal Revenue Code only applies to a 60-day rollover.

The Council disagrees with the view expressed in the newsletter and the 402(f) notice. In our experience, the vast majority of payors of retirement plan distributions have been performing income tax withholding and tax reporting based on prior legal analyses, and their practices are inconsistent with the views reflected in the newsletter and 402(f) notice. In addition, we are not aware of any payors who have changed their reporting

[2] *Employee Plans News*, Volume 10, Spring 2010, *available at* http://www.irs.gov/pub/irs-tege/spr10.pdf.

[3] Notice 2009-68.

1501 M Street NW Suite 600 Washington, DC 20005 202-289-6700 Facsimile 202-289-4582 www.americanbenefitscouncil.org

and withholding procedures in light of the newsletter or 402(f) notice. Many have been reluctant to make costly changes in the absence of precedential guidance. This issue affects tens of thousands of individual taxpayers who are engaging in rollovers involving after-tax amounts and it is critical that the Service issue guidance as soon as practicable. Accordingly, we strongly recommend inclusion of this issue on the 2010-2011 Priority Guidance List.

Carry-Over Items

The Council's members are also anxious to see many of the issues that were on the 2009-2010 Priority Guidance List finalized. We appreciate that the Service and the Treasury Department have had a very busy year, particularly given the substantial demands associated with implementing health reform legislation. Nonetheless, we urge you to finish the many long-standing items on the current Priority Guidance List.

Most notably, we are anxious to see the pending final regulations on cash balance and pension equity plans as well as proposed regulations defining a market rate of return for hybrid plans. These regulations implement legislation enacted as part of the Pension Protection Act of 2006, which was enacted nearly four years ago. While we appreciate the relief the Service has provided in the meantime as well as the complexity of the issues presented, it would be enormously beneficial to have guidance addressing the remaining hybrid plan issues.

If you have any questions about these comments, please contact Jan Jacobson, the Council's senior counsel, retirement policy, at 202-289-6700.

Sincerely,

Jan Jacobson
Senior Counsel, Retirement Policy
American Benefits Council

KEENELAND®

AUG 2 2010

Notice 2010-43

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LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Request to Include an Item on the 2010-2011 Guidance Priority List

Dear Messrs. Shulman and Wilkins:

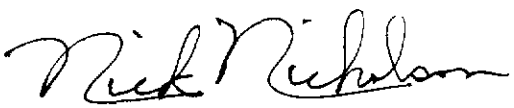
Our organization is writing to express our strong support for the request submitted on June 11, 2010, by Mr. Thomas A. Davis to include in the Guidance Priority List for 2010-2011 guidance changing the definition of "amount wagered" in determining pari-mutuel withholding and reporting. More specifically, the guidance would provide that, for purposes of withholding proceeds from pari-mutuel wagering pursuant to section 3402(q)(3) of the Code and reporting pursuant to Treas. Reg. section 31.3406(g)-2(d)(3), the "amount wagered" would include the total amount wagered by the recipient of the winning proceeds into the pari-mutuel pool from which such proceeds are paid. A copy of the request for inclusion in the Guidance Priority List is attached.

Our organization, Keeneland Association, Inc., located in the Commonwealth of Kentucky, is not only one of the nation's leading racetracks, but also the world's largest horse auction company. There is absolutely no question that our customers are greatly impacted by the IRS withholding and reporting requirements. Additionally, our sport is greatly hampered by the inequities that currently exist between the types of rules and regulations as they relate to other forms of wagering.

Clearly, the standards for reporting and withholding that apply to the pari-mutuel industry place it at a distinct disadvantage compared to other forms of gambling and create a significant administrative burden on racetracks. Over the past few years, wagering on pari-mutuel horse racing has declined dramatically, from $15.10 billion in 2003 to $12.3 billion in 2009. The pari-mutuel horse racing industry—representing nearly 1,000 off-track wagering service sites and some 200 racetracks—has lost market share as horseplayers migrate to other forms of gambling entertainment that do not withhold on winnings. The current rules are both inequitable and discriminatory in favor of other types of gambling. Changing the definition of "amount wagered" would address this inequity.

Thank you for your consideration of this request. If we may provide any additional information or answer any questions, please contact me at 859-288-4214 or nnicholson@keeneland.com.

Sincerely,



Nick Nicholson
President/CEO

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

AUG 2 2010

DAVIS & HARMAN LLP

ATTORNEYS AT LAW

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230
FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

June 11, 2010

DELIVERED VIA ELECTRONIC MAIL

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Request to Include an Item on the 2010-2011 Guidance Priority List

To whom it may concern:

We are writing in response to the invitation by the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "Service") published in Notice 2010-43, 2010-22 I.R.B. 716, for recommendations on items for inclusion on the 2010-2011 Guidance Priority List. For the reasons discussed below and in the attached white paper, we respectfully request that the 2010-2011 Guidance Priority List include guidance changing the definition of "amount wagered" in determining pari-mutuel withholding and reporting.

Background

The current rules that apply to winnings from wagering on horse racing have been in place for many years. However, they do not reflect appropriate or equitable withholding and reporting for the way most wagering is done today.

Section 3402(q)(3)(c) of the Code requires withholding if the wagering proceeds are more than $5,000 from "a wagering transaction in a pari-mutuel pool with respect to horses races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered."

Treasury regulations provide that gambling winnings are reportable on Form W-2G if the amount paid with respect to the wager is $600 or more and the proceeds are at least 300 times the amount of the wager.[1]

[1] *See* Treas. Reg. § 31.3406(g)-2(d)(3) and PLR 7823066 (March 13, 1978).

The withholding requirement came into law in 1976 and, when enacted, applied to proceeds of more than $1,000. The threshold was later increased to $5,000. The reporting requirement was in effect at the time the withholding requirement was enacted in 1976.

The longstanding interpretation of what is considered as the "amount wagered" means that no matter how many combinations a patron bets into a pool in an attempt to have a winning ticket, only the cost of the one winning combination is considered as the amount wagered for withholding and reporting purposes. It does not take into account other wagers involving other combinations placed in that same pool which did not produce any winnings.

For example, in 1978, the Service ruled in PLR 7823066 that:

> We conclude, therefore, that your multiple wager $6 box bet ticket must be considered to be six individual $1 bets and not one $6 bet for purposes of computing the amount to be reported or withheld. Winnings on a $6 box bet must be reported if they are $600 or more and if the winning combination pays off at 300 times the $1 bet; and Federal income tax must be withheld if the winnings amount to more than $1000 after the price of the wager ($1) has been subtracted.

Similarly, the 2009 *Instructions for Forms W-2G and 5754*, in explaining how to treat multiple wagers in the same pari-mutuel pool, restate almost verbatim what was concluded in PLR 7823066.

Problem and Requested Guidance

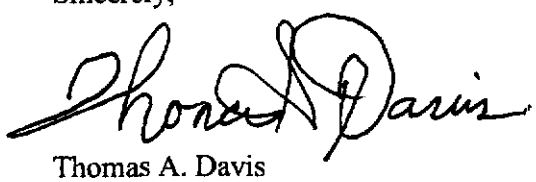
For a wager to pay 300 to 1 odds or higher, the wager must be on some combination of horses coming in the exact order or coming in first in several races. A wager on a single horse to come in first, second, or third will not pay 300 to 1 or more of the amount of the wager. Most pari-mutuel wagering on horse racing today involves picking a combination of horses to come in the exact order, *e.g.*, an Exacta, Trifecta, Superfecta, or Pick 6. To win, a bettor most often places wagers on numerous combinations in hopes of having the one single combination that pays off. However, as explained above, the total wagers placed on the numerous combinations are not taken into account for purposes of determining the bettor's winnings that are subject to withholding. As a result, a larger amount will be withheld than what should have been withheld if winnings reflected the total amount wagered. Attached to this request for guidance is a white paper describing in more detail the problem, a numerical illustration of the problem, and a description of our request for guidance.

In order to achieve more appropriate withholding and reporting to reflect the way most wagering is done today, we respectfully request that the 2010-2011 Guidance Priority List include guidance providing that for purposes of withholding pursuant to section 3402(q)(3)(c) of the Code, and reporting pursuant to Treas. Reg. § 31.3406(g)-2(d)(3), the "amount wagered"

should include the total amount wagered by the recipient of the winning proceeds into the pari-mutuel pool from which such proceeds are paid.

We appreciate your consideration of this request. If we may provide any additional information or answer any questions, please contact Tad Davis at tadavis@davis-harman.com or by phone at (202) 347-2230.

Sincerely,



Thomas A. Davis

Attachment

Request to Change Definition of "Amount Wagered" In Determining Pari-Mutuel Withholding and Reporting

Problem

Unlike all of its competitors in other gaming industries, the pari-mutuel industry is burdened by an inequitable tax law that requires racetracks and other wagering facilities to withhold federal taxes on winnings over $5,000 if the proceeds are at least 300 times the "amount wagered." (*See* Section 3402(q) (3).)

The 2010 Instructions for Forms W-2G and 5754 state: "For multiple wagers sold on one ticket, such as the $12 box bet on a Big Triple or Trifecta, the wager is considered as six $2 bets and not one $12 bet for purposes of computing the amount to be reported or withheld. Winnings on a $12 box bet must be reported if they are $600 or more, and federal income tax must be withheld if the proceeds total more than $5,000...." (*See also* Private Letter Ruling 7823066.) This means that a bettor who places a $10 bet on 200 different combinations in the Trifecta pool and wins on one of those combinations can only count $10 as the amount wagered even though in fact the person has bet $2,000.

In part, due to current tax laws, U.S. wagering on pari-mutuel horse racing has declined from a high of $15.18 billion in 2003 to $12.3 billion in 2009. The pari-mutuel horse racing industry – representing nearly 1,000 off-track wagering service sites, as well as some 200 racetracks – has lost market share as horseplayers migrate to other forms of gambling entertainment that do not withhold on winnings of over $5,000. This migration is not because of a desire to avoid taxes, but because of over-withholding.

Proposed Solution

For purposes of withholding pursuant to Section 3402(q)(3), the "amount wagered" would include the total amount wagered by the recipient of the winning proceeds into the pari-mutuel pool from which such proceeds are paid. For example, if a bettor places 10 bets into a Trifecta pool on 10 different combinations on the three horses that will come in first, second, and third, the cost of all of those bets would be included in the amount wagered for purposes of withholding.

Pari-Mutuel Pools

There is a separate pool for every type of bet that is made on a race. For example, every bet made on a horse to win the race goes into the Win pool, every bet that is made on a horse to finish second goes into the Place pool and every bet on a horse to finish third goes into the Show pool.

There are separate pools in each race for all Exacta bets (which requires picking the horses that finish first and second in the exact order of finish), Trifecta bets (which requires picking the first three horses in the exact order of finish), Superfecta bets (which requires picking the first four horses in the exact order of finish), and pools for any other types of bets that are available on any given race.

There are also separate pools for bets that are made on horses in different races such as the Pick 3 or the Pick 6, which requires picking the winners in several designated consecutive races. When a person has a winning ticket, that person shares the amount in that particular pool (less the takeout, defined below) with everyone else who has a winning ticket in that pool in proportion to the amount that each winner has bet into that pool.

It is highly unlikely that the betting odds from a bet made on a single horse would be 300 to 1 or higher. However, it is quite common for the odds to be over 300 to 1 when picking more than one horse to finish in a particular order, especially when the bet involves more than two horses. Additionally, when people make these types of bets, it is common for them to bet on a number of different combinations to increase their chances of winning.

The Withholding Tax Is Inequitable and Confiscatory

As illustrated by the examples that follow, the definition of the "amount wagered" has a great impact on the determination of whether the winnings are subject to withholding.

Example A

Assume an individual decided to wager a Trifecta (selecting the first-, second-, and third-place finishers in a race, in exact order). To improve his or her chances of winning, the individual selects a group of seven horses in the race and requests a "Trifecta box." By betting a box, the person wins if any three of the seven horses finishes one-two-three (in any order). A seven-horse Trifecta box involves 210 different mathematical combinations. If the person bets $20 on each combination, the total amount wagered is $4,200 ($20 x 210). After the race, the person held a winning ticket that paid $6,100 (which is odds of 305 to 1).

Under the current IRS withholding rules, the racetrack would withhold $1,520 since the rules treat the $20 paid for the **one** winning combination as the **only** amount wagered. The withholding is computed as follows:

$6,100 Proceeds from wager
($20) Amount wagered
$6,080 Winnings
X 25% Automatic withholding
$1,520 Withholding tax

The individual, however, has really only won $1,900 ($6,100 winnings less $4,200 wagered). Consequently, after the withholding tax was taken out, the person was left with a net of only $380, making the withholding rate 80% of the actual winnings.

Example B

The pay-off computations for the winning Trifecta outlined in Example A are changed by defining the "amount wagered" as the actual dollars wagered by that person into the Trifecta pool for that race. The identical wager, in this scenario, results in no withholding as the twin tests of winnings over $5,000 and odds of 300 to 1 or more are not met:

$6,100 Proceeds from wager
$4,200 Amount wagered
$1,900 Winnings (less than the $5,000 threshold)

The person may be able to get back the over-withholding in Example A by claiming the balance of what was bet on the Trifecta as a miscellaneous itemized deduction on his or her tax return when it is filed the following year. But withholding by this procedure takes that money out of the wagering cycle for a

long time. Further, if the person is subject to the Alternative Minimum Tax (AMT), as many Americans are, he or she would not be able to claim the loss against the winnings because miscellaneous itemized deductions are not allowed to be deducted in computing AMT. It is also possible that the bettor would not be able to claim the losses against the winnings if that person does not itemize when filing their return but uses the standard deduction, or if the person is subject to limits on the amount of his/her deductions due to income. Not only is this unfair and confiscatory to the person who won, it has serious detrimental ramifications for the racetracks and other waging facilities, as is explained below.

Impact of Withholding

Statistics show that each pari-mutuel dollar returned to the bettor in the form of winnings is re-bet seven times throughout the course of a day. A pari-mutuel dollar wagered on a track on an exotic wager is generally apportioned as follows, with taxes, track operations, purses, and other programs collectively defined as "takeout":

Returned to bettors in the form of winnings	80%
State and local taxes	2%
Track operations	9%
Purses	8%
Other programs	1%
Total	100%

As the figures above illustrate, a diminution in pari-mutuel "churn" (re-betting of a pari-mutuel dollar) by the automatic 25% withholding on winnings of over $5,000 at odds of 300 to 1 or more also impacts the collection of additional tax revenue at the local, state and federal levels, which is paid by each racetrack operator on its net revenues.

Why Is the Racing Industry Seeking this Change Now?

Over the past decade, the number and type of non-pari-mutuel forms of wagering that offer "mega" prizes have grown substantially. Native American casinos, riverboat casinos, lotteries and land-based casinos all offer some form of jackpot-style payout. Horse racing has developed its own wager types that carry the potential to produce large payouts to compete against lotteries or progressive slot machines. Since the introduction of the Trifecta in 1971, followed by wagers such as the Pick 6 (winners of six consecutive races) in the 1990s, horse racing fans have steadily migrated away from simple Win, Place and Show bets to combination or exotic wagers that offer the prospect of large pay-offs.

Exotics are now the most popular form of wagering. For example, bettors wagering on Kentucky Derby day typically pay collectively about $2.5 million in federal withholdings for exotic wagers placed on one race card. A $2 Trifecta bet on the horses that finished first, second, and third in the 2010 Kentucky Derby paid $2,337, but virtually all of those who won the Trifecta bet substantially more than $2 to have a winning ticket.

Every one of horse racing's 1,200+ wagering service sites must calculate, track, withhold, and forward to the IRS any federal tax due on winnings of over $5,000. This process requires the expenditure of thousands of man-hours processing IRS withholdings and producing Forms W-2G. Casinos are not subject to this requirement. Lotteries avert the IRS withholding by offering tickets that pay less than

$5,000 or substantially more than that amount (with relatively few winners and prizes typically paid out as annuities).

Approximately 30 million Americans wager on pari-mutuel horse racing each year. Due to the growing popularity of exotic wagering across all fan groups, virtually any horseplayer may find him or herself standing in the "IRS line" at a racetrack. Such an experience places an undue burden on horseplayers and is a clear disincentive for them to continue to wager on horse racing.

Nowhere is this more true than at a "racino" – a combination racetrack and casino – where players experience no withholding on casino-style gaming, but when wagering on horse racing in the same facility are subject to automatic withholding if winnings are over the threshold and the odds are at least 300 to 1. This bifurcated system is in place at 44 racinos in 12 states, including major racing states such as Florida, New York, Louisiana, and Pennsylvania.

Current Withholding and Reporting Requirements for Various Types of Gambling Winnings

Type of Wagering	Withholding Requirement	Reporting Requirement
Tournament Poker Winnings	None	Over $5,000
Keno	None	$1,500 or more
Bingo and Slots	None	$1,200 or more
Casino Games (Blackjack, etc.)	None	None
Pari-Mutuel Wagering	**Over $5,000 and odds of at least 300 to 1**	**$600 or more and odds of at least 300 to 1**
Lotteries and Sweepstakes	Over $5,000	$600 or more and odds of at least 300 to 1

Current regulations should be updated to reflect the current wagering practices in horse racing.

Reporting Requirements Should Be Updated

Current reporting requirements also need to be updated to reflect the realities of pari-mutuel wagering today. As outlined above, the reporting requirements vary by type of wagering. They range from a threshold of $600 for pari-mutuel winnings to a threshold of $5,000 for tournament poker winnings. The reporting requirements for pari-mutuel winnings have been in place for more than 30 years and pre-date the enactment of withholding on pari-mutuel winnings in 1976.

The most recent IRS withholding change in this area took place in October 2007, when the IRS established a reporting threshold of $5,000 and determined that no withholding was required for tournament poker winnings. (*See* Revenue Procedure 2007-57 and IRS News Release IR-2007-173.) A standardized level of reporting and withholding, consistent with the rules established for tournament poker, would bring greater uniformity, simplicity and equity to the tax code for gambling winnings. Additionally, the determination of the "amount wagered" should be the same for pari-mutuel reporting purposes as proposed herein for withholding.

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

AUG 2 2010

HARNESS TRACKS OF AMERICA

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(520) 529-2525 • Fax (520) 529-3235 • e-mail: info@harnesstracks.com
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Paul J. Estok, Executive Director and General Counsel
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Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Request to Include an Item on the 2010-2011 Guidance Priority List

Dear Messrs. Shulman and Wilkins:

I am writing to you on behalf of Harness Tracks of America to express our strong support for the request submitted on June 11, 2010, by Mr. Thomas A. Davis to include in the Guidance Priority List for 2010-2011 guidance changing the definition of "amount wagered" in determining pari-mutuel withholding and reporting. More specifically, the guidance would provide that, for purposes of withholding proceeds from pari-mutuel wagering pursuant to section 3402(q)(3) of the Code and reporting pursuant to Treas. Reg. section 31.3406(g)-2(d)(3), the "amount wagered" would include the total amount wagered by the recipient of the winning proceeds into the pari-mutuel pool from which such proceeds are paid. A copy of the request for inclusion in the Guidance Priority List is attached.

Harness Tracks of America is a trade association of 28 of the finest harness racing organizations in North America dedicated to the advancement and progress of the sport. Our members encompass facilities that wager hundreds of millions of dollars on Standardbred, Thoroughbred and Quarter Horse racing each year.

Over the past few years, wagering on pari-mutuel horse racing has declined dramatically, from $15.10 billion in 2003 to $12.3 billion in 2009. The pari-mutuel horse racing industry – representing nearly 1,000 off-track wagering service sites and some 200 racetracks – has lost market share as horseplayers migrate to other forms of gambling entertainment that do not withhold on winnings. The current rules are both inequitable and discriminatory in favor of other types of gambling. Changing the definition of "amount wagered" would address this inequity.

Thank you for your consideration of this request. If we may provide any additional information, or answer any questions, please contact Paul J. Estok, Executive Director, at Harness Tracks of America, 4640 East Sunrise Drive, Tucson, Arizona 85718, by e-mail at paul.estok@azbar.org, or by telephone at 520-529-2525.

Sincerely,

Paul J. Estok

Notice 2010-43

DICKSTEINSHAPIRO LLP

1825 Eye Street NW | Washington, DC 20006-5403
TEL (202) 420-2200 | FAX (202) 420-2201 | dicksteinshapiro.com

JUL 27 2010

LEGAL PROCESSING DIVISION
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BRANCH

July 22, 2010

DELIVERED VIA ELECTRONIC MAIL

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Request to Include an Item on the 2010-2011 Guidance Priority List

To whom it may concern:

I am legislative counsel for the American Greyhound Track Operators Association (AGTOA), and I am writing in response to the invitation by the Department of the Treasury (the "Treasury") and the Internal Revenue Service (the "Service") published in Notice 2010-43, 2010-22 I.R.B. 716, for recommendations on items for inclusion on the 2010-2011 Guidance Priority List.

AGTOA was formed in April 1946, as a non-profit corporation composed of the owners and operators of 36 greyhound tracks located throughout the United States. Membership is open to all lawfully licensed greyhound racetrack owners, whether they are individuals, partnerships, or corporations. Over the past several years pari-mutuel dog racing has experienced at least, if not a more precipitous decline in wagering than horse racing.

Similar to the June 11th letter written by Thomas Davis, AGTOA members respectfully suggest that IRS include guidance that would change the definition of "amount wagered" in determining pari-mutuel withholding and reporting. The existing rules do not reflect current wagering practices and a more appropriate and reasonable withholding and reporting approach is needed.

Section 3402(q)(3)(c) of the Code requires withholding if the wagering proceeds are more than $5,000 from "a wagering transaction in a pari-mutuel pool with respect to horses races, dog races, or jai alai if the amount of such proceeds is at least 300 times as large as the amount wagered." Treasury regulations provide that gambling winnings are reportable on Form W-2G if

the amount paid with respect to the wager is $600 or more and the proceeds are at least 300 times the amount of the wager.[1]

The current system is not appropriate for contemporary pari-mutuel wagers at the dog tracks. For a wager to pay 300 to 1 odds or higher, the wager must be on some combination of dogs coming in the exact order or coming in first in several races. A wager on a single greyhound to come in first, second, or third will not pay 300 to 1 or more of the amount of the wager. However, similar to horse wagering, as explained in the June 11th letter written by Thomas Davis, total wagers placed on the numerous combinations at greyhound tracks are not taken into account for purposes of determining the bettor's winnings that are subject to withholding. As a result, a larger amount will be withheld than what should have been withheld if winnings reflected the total amount wagered.

Therefore, we support the effort to obtain a guidance that would better reflect today's wagering system within the pari-mutuel wagering. We request that the 2010-2011 Guidance Priority List include guidance providing that for purposes of withholding pursuant to section 3402(q)(3)(c) of the Code, and reporting pursuant to Treas. Reg. § 31.3406(g)-2(d)(3), the "amount wagered" should include the total amount wagered by the recipient of the winning proceeds into the pari-mutuel pool from which such proceeds are paid.

We appreciate your consideration. If you have additional questions or need further information regarding the pari-mutuel greyhound racings, please feel free to contact me.

Sincerely,

Henry C. Cashen II

HCC/kbb

[1] *See* Treas. Reg. § 31.3406(g)-2(d)(3) and PLR 7823066 (March 13, 1978).

LEGAL PROCESSING DIVISION
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BRANCH

Notice 2010-43

JUL 16 2010

Johnson LaTashia M

From: Nelson Blakely [nmblakely@gmail.com]
Sent: Thursday, July 15, 2010 2:23 PM
To: Notice Comments
Subject: Notice 2010-43

Counsel:

I know the initial deadline for submitting topics for the 2010-2011 Priority Guidance Plan has passed, but I hope you will consider my topic for a supplement to the Plan.

Topic: Publishing Guidance for Section 6166 Bifurcation Computations

Reason: IRM 4.25.2.1.6.4 is available to the public on the IRS web site (at www.irs.gov). This sub-part of the IRM provides:

4. If the decedent owns two businesses that independently qualify for the IRC section 6166 election, the estate may elect to bifurcate the installment payments. Bifurcation allows the taxpayer to pay taxes attributable to each closely held business over the longest installment period available for that particular business. To receive this treatment, the executor must make a separate election for each business.

Prior to my retirement from IRS on January 1, 2010, I was involved with Counsel in drafting an early version of proposed regulations to replace existing Regulation sections 20.6166-1 *et seq.* I worked initially with Laura Daly, Esq. and Alicia Goldstein, Esq. (both of whom have moved on to other areas within Counsel). I ran a number of computations with various bifurcation scenarios as part of this early draft process. At the same time I also worked some actual field exam computations where estates had made bifurcation allocations within section 6166(c) elections (which is at odds with the IRM direction published in late 2009). One case involved interrelated Federal and Minnesota bifurcated section 6166 elections.

The published IRM provision will only serve to increase the number of bifurcation elections that will be filed after an estate tax is reinstated. At present there is no published guidance showing how to do a bifurcation computation. Estates of decedents who died in 2009 will continue to be filed until early 2011. There may well be field examinations of bifurcated 6166 elections continuing through 2013.

If you have any questions please contact me.

Thank you.

Nelson M. Blakely
Attorney at law
1066 Spruce Lane
Perkasie, PA 18944
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215.795.0828 (Fax)
nmblakely@verizon.net
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nmblakely@section6166.com

Notice 2010-43

From: Maria Wong [MWong@aptiumoncology.com]
Sent: Wednesday, June 09, 2010 12:30 PM
To: Notice Comments
Subject: Notice 2010-43

LEGAL PROCESSING DIVISION
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BRANCH
JUN 9 2010

Notice 2010-43

2 Comments:

1. Form W-9, Request for Taxpayer Identification and Certification – The Form W-9 is currently used by taxpayer to provide the information to their customers or clients. The information is mainly their taxpayer identification and type of entity. Such information is then used for the Form 1099 reporting after year end.

    a. Problem - Since the Form W-9 is frequently completed incorrectly by the taxpayers, this has caused the situation of unmatched data for the Form 1099 reporting.

    b. Suggestion – Instead of having a blank W-9 for the taxpayer to fill out, IRS can issue a standard letter to each taxpayer as they register their business and obtain their taxpayer identification number. This letter would show the information that used to be on the Form W-9. The taxpayer can provide a copy of this letter to their customers or clients to facilitate the 1099 reporting later after year end. This would eliminate the situation of having unmatched data on the 1099s.

2. Gift limited to $25 each payee for the tax year – Currently Regs 1.274-3(a) allows taxpayers to deduct gift up to $25 per year given to each individual.

    a. Problem – The $25 limit was established many years ago when the cost of living was much lower. $25 nowadays is not even sufficient to send a bouquet of flowers to a customer or client to show one's appreciation of their business.

    b. Suggestion – Raise the $25 to an amount which is not extravagant and yet a legitimate business gift can be deductible for income tax purposes. For example, the amount for the limit can be raised to $80 or $100.

Please consider the above items for the 2010-2011 Guidance Priority List.

If there are any questions, please contact me at 323-966-3584 Monday through Friday, 9 am to 4 pm. Thank you.

Maria Wong
Manager of Taxation
Aptium Oncology (fka Salick Health Care)
8201 Beverly Blvd.
Los Angeles, CA 90048
Tel (323) 966-3584
Fax (323) 966-3686

Notice 2010-43

JUN 14 2010

LEGAL PROCESSING DIVISION
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June 11, 2010

VIA EMAIL TO: Notice.Comments@irscounsel.treas.gov

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P. O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2010-43 – Recommendations on IRS 2010-2011 Guidance Priority List

To Whom It May Concern:

CharitablePlanning.com ("CPC"), a website devoted to charitable estate and financial planning, has the following suggestions for IRS to consider as it identifies and prioritizes tax issues to be addressed through published guidance for the fiscal year July 1, 2010 through June 30, 2011.

1 – Gift/Sale of an Income Interest in a Charitable Gift Annuity to Charity

An income interest in a charitable gift annuity ("CGA") is a capital asset under Section 1221 of the Internal Revenue Code of 1986, as amended from time to time ("Code"). [Note: All references to "Section" shall be to sections of the Code, unless clearly indicated to the contrary.] If the income interest in the CGA were sold, the amount of the gain would be determined under Section 72. To the extent the amount received exceeded the investment in the contract as defined by Section 72(e)(6), it would be included in gross income under Section 72(e)(5)(A).

Section 72, specifically Section 72(e), does not characterize the nature of the gain as ordinary income or capital gain. Although the income interest is a capital asset, some or all of the gain may be characterized as ordinary income if the substitute for ordinary income doctrine applies. See *United States v. Midland-Ross Corp.*, 381 U.S. 54, 57 (1965) and *Commissioner v. P.G. Lake, Inc.*, 356 U.S. 260 (1958).

In May, 2009 the Service issued Rev. Rul. 2009-13, 2009-21 IRB 1029 and Rev. Rul. 2009-14, 2009-21 IRB 1031, which address the tax consequences of selling and buying preexisting life insurance contracts. The sale of an income interest in a CGA is no different than Situation #2 in Rev. Rul. 2009-13.

A significant number of charities today are requesting that donors gift their income interests in CGAs back to the charity, but the gift annuitants are unsure of the tax consequences. If a hypothetical sale would produce capital gain as set forth in Situation #2, then the gift of the income interest is deductible under Section 170 to the extent of its fair market value (which is the present value of the income interest in the CGA, determined according to actuarial tables). On the other hand, if the gain on a hypothetical sale would produce ordinary income, then the donor's deduction would be limited to his or her investment in the contract.

CPC urges the IRS to issue a Revenue Ruling similar to 2009-13 with respect to a gift of an income interest in a CGA. This would promote sound tax administration by clarifying an uncertain area, in a manner consistent with a very similar asset (that is, life insurance), and would be easily understandable by taxpayers. The requested guidance can easily be administered on a uniform basis, similar to life insurance. Finally, this will lessen the burdens on taxpayer and the IRS by resolving an issue that otherwise might be the subject of potentially numerous private letter ruling requests.

2 – An Outright Gift to a Single Member Limited Liability Company ("SMLLC") Solely Owned by a Charity is a Gift to the Charity

Frequently, charities do not want to receive outright gifts of non-cash assets and hold such assets as part of their general endowment, as the asset might produce unwanted liabilities. For example, if a donor wanted to give land and buildings to a charity, the charity may desire to accept the gift in a SMLLC, which limits its liability for environmental issues, casualty losses, etc. At times, a donor may want to make additional contributions to the SMLLC of other noncash assets.

The SMLLC is considered to be an appropriate recipient by a significant number of charities which accept non-cash gifts, so the problem is wide-spread.

Section 301.7701-3(a) of the Procedure and Administration Regulations provides, in part, that a business entity that is not classified as a corporation under Section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) of the Procedure and Administration Regulations (an "eligible entity") can elect its classification for federal tax purposes as provided in Section 301.7701-3 of the Procedure and Administration Regulations. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under Section 301.7701-2(b)(2) of the Procedure and Administration Regulations) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Section 301.7701-3(b)(1)(ii) of the Procedure and Administration Regulations provides that unless a domestic eligible entity elects otherwise, the entity is disregarded as an entity separate from its owner if it has a single owner. Assuming that a SMLLC does not elect to be treated as separate from its sole member on Form 8832, the SMLLC will be disregarded as an entity separate from its owner.

Unfortunately, no ruling by the Service has ever stated that a gift to a SMLLC solely owned by a Section 501(c)(3) charity is deductible under Section 170 as if the gift were made directly to the charity.

CPC urges the IRS to issue a Revenue Ruling stating that a gift to a SMLLC that is solely owned by a charity is equivalent to a gift outright to the charity. Because this problem is prevalent in the charitable arena, a solution would promote sound tax administration, can be drafted to be easily understood by taxpayers, can be applied uniformly by the Service, and will reduce the burden on taxpayers and the Service.

CPC considers both items of importance to the charitable community, and requests that the Service issue revenue rulings on both topics.

Sincerely yours,

Emanuel J. Kallina, II
Editor-in-Chief
www.CharitablePlanning.Com
Emil.Kallina@charitableplanning.com

Notice 2010-43

MAY 13 2010
PUBLICATION & REGULATIONS BRANCH

Johnson Regina

From: BeneSource@aol.com
Sent: Thursday, May 13, 2010 6:24 AM
To: Notice Comments
Subject: "Notice 2010-43"

To Whom It May Concern:

I would like to verify the small business tax credit under the recently passed Health Care Reform, as follows:

I have read that an employer who is currently deducting the cost of medical insurance as a business expense can **not also have a tax credit on the same amount.**

Since, most if not all small businesses deduct the amount they pay for employee's medical insurance, in effect then they would not be eligible for the tax credit. Please clarify.

Thank you,

Keith J. Bell, CIC
(860) 704-8020 ext. 202
(860) 286-8887 Fax
(860) 716-3089 Cell Phone

American Benefits Alliance
Caring through Action

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Notice 2010-43

LEGAL PROCESSING DIVISION
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BRANCH
JUN 9 2010

From: McCulloch, John [jmcculloch@epssettlements.com]
Sent: Wednesday, June 09, 2010 9:30 AM
To: Notice Comments
Subject: Notice 2010-43
Importance: High
Attachments: Ltr to IRS Commissioner Shulman dated 06 08 2010.pdf

We respectfully request that the Internal Revenue Service (the "Service") and Treasury Department ("Treasury") publish Final Regulations under section 104(a)(2) of the Internal Revenue Code (the "Code") to clarify the scope of the exclusion for damages received on account of personal "physical" injuries or "physical" sickness pursuant to Notice 2010-43. Neither the Code, the Proposed Regulations nor formal guidance from the Service provide a definition of either "physical injury" or "physical sickness." Our proposal is in the attached letter and we specifically seek that childhood molestation and long-term wrongful incarceration be defined as "per se" physical injuries.

Thank you in advance for your consideration of this matter. Should you have any questions, please contact us.

John McCulloch

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National Marketing Director

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June 8, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Recommendation for 2010-2011 Guidance Priority List

Dear Commissioner Shulman:

We respectfully request that the Internal Revenue Service (the "Service") and Treasury Department ("Treasury") publish Final Regulations under section 104(a)(2) of the Internal Revenue Code (the "Code") to clarify the scope of the exclusion for damages received on account of personal "physical" injuries or "physical" sickness.

On September 14, 2009, Treasury and the Service issued Proposed Regulations under Section 104(a)(2) to eliminate the requirement that damages received must be based upon "tort or tort-type" rights to be excluded from gross income. However, neither the Code, the Proposed Regulations nor formal guidance from the Service provide a definition of either "physical injury" or "physical sickness."

The boundary line between a physical injury and a nonphysical injury (such as purely emotional distress which the Proposed Regulations exclude from the scope of section 104(a)(2)) is not always clear. However, we believe the Final Regulations should clarify that two specific types of injuries qualify as *per se* physical injuries under section 104(a)(2).

Specifically, we request guidance that childhood sexual abuse cases and long-term wrongful incarceration (at least one year of restraint) are *per se* physical injuries under section 104(a)(2).

There is a significant body of literature that recognizes childhood sexual abuse as a serious medical problem with long lasting and severe physical manifestations, many of which can only be treated by a licensed medical practitioner or through the prescription of controlled medications. There are similar medical studies that demonstrate the persistent physical damage that results from long-term incarceration.

Appropriateness of Inclusion of Requested Section 104(a)(2) Guidance on the 2010-2011 Guidance Priority List.

Pursuant to Notice 2010-43, the Treasury and the Service consider the following in reviewing recommendations and selecting projects for inclusion on the 2010-2011 Guidance Priority list: (i) whether the recommended guidance resolves significant issues relevant to many taxpayers; (ii) whether the recommended guidance promotes sound tax administration; (iii) whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; (iv) whether the Service can administer the recommended guidance on a uniform basis; and (v) whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

It is respectfully submitted that the requested section 104(a)(2) guidance satisfies each of the criteria enumerated above. Since the amendment to section 104(a)(2) in 1996, taxpayers have been in need of guidance to determine the scope of the terms "physical injury" and "physical sickness." The application of section 104(a)(2) to the victims of childhood sexual abuse and wrongful incarceration affects a large and growing number of taxpayers, in the former case because of greater opportunities for victims to come forward after legislation in many states which extends applicable statutes of limitations and in the latter case because of more widely available DNA-testing to absolve wrongfully convicted prisoners. The requested section 104(a)(2) guidance would promote sound tax administration by providing an understandable tax rule for these victims, thereby minimizing the likelihood of future controversies. It would also provide consistency in tax treatment among such victims who face uncertainties and expense as they attempt to address the issue in an individualized basis.

We would appreciate the opportunity to discuss this issue with you and others from the Service and Treasury. If you have any questions or would like additional information, please contact us at (630) 922-8830. Thank you in advance for your consideration of this request.

Respectfully submitted,

David Shechtman
Drinker Biddle & Reath

John McCulloch
Integrated Financial Settlements

GROOM

Notice 2010-43

William F. Sweetnam, Jr.
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bsweetnam@groom.com

Louis T. Mazawey
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JUN 14 2010
LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

June 11, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Recommendations for 2010-2011 Guidance Priority List

Dear Sirs and Madams:

Pursuant to Notice 2010-43, we recommend that the Internal Revenue Service (IRS) include, on the 2010-2011 Guidance Priority List, a guidance project that would provide permanent relief for tax-exempt retirement plans – and the persons responsible for their investment affairs – from (1) any requirements to file a Report of Foreign Bank and Financial Accounts (commonly referred to as "FBAR"), and (2) any requirement for these company officials to provide information about pension plan investments on their individual tax returns.

This guidance project should be included in the 2010-2011 Guidance Priority List – and guidance should be issued as soon as possible under the new plan – for the following reasons, reflecting the considerations listed in Notice 2010-43.[1]

1. Guidance regarding certain relief from FBAR filing involves significant issues that are relevant to the many taxpayers that sponsor tax-qualified retirement plans and the persons responsible for their investment affairs. The specter of thousands of retirement plans confronting the costly and burdensome FBAR requirements was first raised one year ago – in response to informal comments of officials of the IRS concerning FBAR compliance by offshore hedge funds commonly used by tax-exempt retirement plans – and remains unresolved to this day.

[1] We understand that FBAR is not solely within the jurisdiction of Treasury and the Service, but note that representatives of the International Tax and SB/SE branches share some responsibility for FBAR with the Office of Financial Crimes Enforcement Network.

2. Relief from FBAR filing would not impede sound tax administration for the following reasons:

- the objectives of FBAR reporting are already achieved by the current regulatory requirements for retirement plans since federal law imposes detailed financial reporting requirements, and rigorous fiduciary standards, on retirement plans and plan officials, and
- such entities pose virtually no risk of tax evasion, money laundering or terrorist activities – the concerns underlying the FBAR scheme.

3. The relief can be drafted in a manner that is easily understood by tax-exempt retirement plans and the persons responsible for their investment affairs. Rather, it is the FBAR reporting that is confusing and burdensome to plans and plan officials. In addition, we are concerned that the FBAR reporting requirements will make individuals less willing to participate in the investment affairs of these plans.

4. The proposed relief would be easy for the IRS to administer, since it would only apply to tax-exempt retirement plans and the persons responsible for their investment affairs.

5. The relief from FBAR reporting that we request in this letter would greatly lessen the burdens on both the IRS and on tax-exempt retirement plans and the persons responsible for their investments.

We appreciate your considering this request. A letter containing our most recent comments and recommendations in this area are enclosed. We are available to discuss this request with you at any time.

Sincerely,

William F. Sweetnam, Jr.

Louis T. Mazawey

Enclosure

Notice 2010-43

INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

JUN 14 2010
LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Karrie McMillan
GENERAL COUNSEL

202/326-5815 FAX: 202/326-5812
kmcmillan@ici.org

By Electronic Delivery

June 11, 2010

The Honorable Michael Mundaca
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

RE: Guidance Priority List Recommendations on Retirement Security Issues

Dear Mr. Mundaca and Mr. Wilkins:

The Investment Company Institute[1] is pleased to submit recommendations regarding retirement security issues for projects to be included on the 2010-2011 Guidance Priority List. A separate ICI submission describes our recommendations regarding regulated investment companies.

I. Items from 2009-2010 Guidance Priority List

First, we request guidance, possibly in the form of a revenue ruling, regarding how to accomplish an effective 403(b) plan termination.[2] In particular, there is significant confusion surrounding termination of 403(b) plans funded through individual custodial accounts. Effective plan termination depends on distribution of all accumulated benefits within a reasonable period of time. Individual custodial accounts, however, typically do not provide for distribution without the consent of the participant. Therefore, any participant who fails to request a cash distribution or rollover of his or her 403(b) account could jeopardize the effectiveness of the termination.

To resolve this issue, we recommend that guidance provide for at least two possible alternatives as valid means of plan termination: (1) taxation of any remaining balances in individual accounts after a

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.97 trillion and serve almost 90 million shareholders.

[2] *See* ICI letter to W. Thomas Reeder, dated March 17, 2009; and ICI letter to W. Thomas Reeder, dated Nov. 12, 2008.

specified period (e.g., one year) and (2) automatic rollover to an IRA after a specified period, to the extent permitted by the custodial agreement and plan. Guidance in this regard will facilitate any necessary amendments to custodial agreements to permit automatic rollovers to IRAs in connection with plan termination and would allow custodians to rely on an employer's direction that a plan is being terminated. The Institute has strongly urged that this guidance be published as soon as possible, given that some employers have begun the process of terminating their 403(b) plans pursuant to the 2007 final regulations issued under section 403(b).[3]

Second, we request finalization of the draft prototype program for 403(b) plans described in Announcement 2009-34 and sample plan language released concurrent with the Announcement. It is important to establish an opinion letter program for 403(b) prototype plans so that employers and plan service providers can have greater certainty in operating under the new 403(b) regulations and guidance. As we have recommended previously,[4] certain changes should be made to the draft Revenue Procedure and sample plan language, including allowing the terms of individual agreements to govern as appropriate and, for other purposes, allowing individual agreements to incorporate plan provisions by reference. We also urge the Service to allow prototype 403(b) plans to use vesting schedules.

II. New 2010-2011 Guidance Priority List Items

The Institute requests that the Service add the following retirement security matters to the 2010-2011 Guidance Priority List. First, we request guidance on partial rollovers of plan distributions containing after-tax employee contributions. A sentence included in the updated model 402(f) notice published in September 2009 has created confusion regarding the allocation of after-tax basis and pre-tax amounts in a distribution that is partially rolled over to a plan or IRA. Under the prevailing view of practitioners and service providers, Code section 402(c)(2) provides that in a distribution containing after-tax amounts that is partially rolled over (directly or indirectly), pre-tax amounts are considered rolled-over first. In the view espoused in the model 402(f) notice, however, pre-tax amounts would be considered rolled-over first only in an indirect rollover; in a direct rollover, the amount rolled over would consist of a pro-rata share of basis and pre-tax amounts. We strongly urge the Service to issue guidance and a revised 402(f) notice confirming that the former view – pre-tax first – is correct. There is no statutory authority that compels the interpretation espoused in the 402(f) notice, and in the interests of sound tax policy, indirect rollovers should not be favored over direct rollovers.[5] At a minimum, if the Service is unwilling to reverse the pro-rata interpretation implied by the 402(f) notice, we feel it is imperative to enforce the pro-rata rule for partial rollovers prospectively only. Due to the

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[3] 72 Fed. Reg. 41128 (July 26, 2007).

[4] *See* ICI letter to Internal Revenue Service re: Announcement 2009-34, dated June 1, 2009.

[5] A participant desiring to roll over the taxable part of a distribution to another plan or IRA, while receiving the non-taxable portion in cash or rolling it over into a separate vehicle, could do so via an indirect 60-day rollover, but ostensibly could not accomplish the same result via direct rollover under the Service's recent interpretation.

multitude of past transactions thought to be properly executed under 402(c)(2), anything other than prospective enforcement would cause considerable disruption and challenges.

Second, we request that the Service finalize the proposed regulations implementing section 1102 of the Pension Protection Act, which instructed the Secretary of the Treasury to modify the regulations under section 411(a)(11) to require disclosure of the consequences of failing to defer receipt of a distribution from a defined contribution plan.[6] We strongly recommend that the Service finalize the requirements as proposed. As we stated in our comment letter,[7] the proposal strikes the right balance by alerting the participant that the plan may have investments, or fee structures, different from those obtainable in an IRA, and alerting the participant that more information is available. This approach will not overwhelm the participant with information that obscures the key information while also assuring the participant has access to information consequential to the decision whether to take or defer a distribution from the plan.

Third, we request guidance on the proper tax treatment of escheated amounts from retirement plans and IRAs. In 2004, the Department of Labor ("DOL") issued guidance regarding missing participants in terminating defined contribution plans.[8] The DOL guidance requires that a plan administrator use certain search methods to locate a missing participant, and if all efforts to locate the missing participant fail, then the fiduciary should consider distributing the amounts to a federally insured bank account or escheating them to a state unclaimed property fund. The requested guidance should address certain federal tax implications of escheatment, including (1) whether Form 1099-R reporting is required, (2) whether payors should designate amounts as escheated and, if so, how payors should make such a designation, and (3) whether withholding is required. We have requested this guidance in prior years and we wish to reiterate its importance. We understand that several states have increased their efforts to collect unclaimed property in IRAs and other retirement plans.

Finally, we request guidance complementing the DOL's final regulations on the termination of abandoned plans.[9] This guidance should implement language in the preamble to the DOL's regulations that the Service will not challenge the qualified status of any plan termination under the DOL's regulations or take any adverse action against a "qualified termination administrator" (the party that assumes responsibility for plan distributions and termination), the plan, or any participant or beneficiary of the plan as a result of the termination, provided that several conditions are met.[10] The

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[6] 73 Fed. Reg. 59575 (Oct. 9, 2008).

[7] *See* ICI letter to Internal Revenue Service re: proposed regulation (REG-107318-08), dated January 7, 2009.

[8] U.S. Department of Labor, Employee Benefits Security Administration, Field Assistance Bulletin No. 2004-02, dated September 30, 2004.

[9] 71 Fed. Reg. 20820 (April 21, 2006).

[10] These conditions are as follows: (1) the qualified termination administrator reasonably determines whether, and to what extent, the survivor annuity requirements of sections 401(a)(11) and 417 apply to any benefit payable under the plan; (2) each participant and beneficiary must have a non-forfeitable right to the benefit as of the deemed termination date, subject

guidance also should clarify how parties other than a participant can establish IRAs for abandoned plan accounts;[11] under the DOL's regulations, IRAs for abandoned plan participants could be established by default — without the participant's involvement — in a manner similar to IRAs established under the automatic rollover rules of EGTRRA.

* * *

If we can provide you with any additional information regarding these issues, please do not hesitate to contact Elena Chism at 202/326-5821 or the undersigned at 202/326-5815.

Sincerely,

Karrie McMillan
General Counsel

cc: J. Mark Iwry
George H. Bostick

---

to income, expenses, gains, and losses between that date and the distribution date; and (3) participants and beneficiaries must receive notification of their rights under section 402(f).

[11] *See* Notice 2005-5; Institute Letter to the U.S. Department of Labor, dated March 10, 2003.

Notice 2010-43

INVESTMENT COMPANY INSTITUTE

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JUN 14 2010

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Keith Lawson
SENIOR COUNSEL – TAX LAW

202/326-5832 FAX: 202/326-5841
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By Electronic Delivery

June 11, 2010

The Honorable Michael Mundaca
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

RE: Guidance Priority List Recommendations

Dear Mr. Mundaca and Mr. Wilkins:

The Investment Company Institute[1] recommends the following issues affecting regulated investment companies ("RICs") and their shareholders for inclusion on the 2010-2011 Guidance Priority List.[2] As requested in Notice 2010-43, these recommendations have been listed in order of priority. The Institute notes, however, that all of the issues described below are important to the industry and their shareholders; most of these items have been included in prior requests for guidance from the Internal Revenue Service ("IRS") and the Treasury Department, including prior suggestions for the Guidance Priority List.

I. 2009-2010 Guidance Priority List Items

The Institute requests that the IRS and Treasury Department issue guidance as soon as possible on the following items currently on the 2009-2010 Guidance Priority List.

A. Final Regulations on Cost Basis Reporting

First, the Institute urges the IRS and Treasury Department to issue final regulations, implementing the mandatory cost basis reporting requirements enacted in 2008, that adopt our recommendations. As discussed in our comment letters,[3] the proposed regulations raise many issues

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.97 trillion and serve almost 90 million shareholders.

[2] A separate submission describes our Guidance Priority List recommendations for retirement security issues.

[3] *See* Institute letters to William J. Wilkins dated February 8, 2010, and May 25, 2010.

that must be resolved before mutual funds and brokers can begin the necessary programming and systems changes. We believe that our proposed solutions would make implementation of this new reporting regime more workable, easing the burdens to brokers, shareholders, and the government while preserving the goals of the statute. As the IRS and Treasury Department are aware, guidance is needed as soon as possible so the industry can comply fully with the January 1, 2012 effective date.

B. Distressed Debt

Second, the Institute requests guidance addressing the accrual of interest on distressed debt. Investors have long faced uncertainty regarding how the existing original issue discount and market discount rules should apply to severely distressed, and speculative, debt. In other cases, application of these rules creates what many believe to be inappropriate results.[4] These issues have been exacerbated by recent market events.[5]

C. Notional Principal Contracts

Third, the Institute remains very interested in guidance providing simplicity and certainty regarding the taxation of notional principal contracts. In our letter on the regulations proposed in 2004,[6] we expressed reservations about the proposed regulations' complexity and recommended significant modifications. We recommended that marks under the elective mark-to-market method, as well as value payments under the noncontingent swap method, be treated as resulting in capital gain or loss. We also suggested that credit default swaps and certain short-term swaps be excluded from the modified noncontingent swap method and the mark-to-market election. We requested additional guidance on determining whether a payment is "significant." We also commented on several technical issues. Finally, we suggested that the guidance should be made entirely prospective upon promulgation of final regulations.

D. Prepaid Forward Contracts

Finally, we urge guidance on prepaid forward contracts.[7] Specifically, the Institute strongly supports prompt and comprehensive guidance regarding the tax treatment of exchange-traded notes ("ETNs"). While ETNs can provide important investment opportunities, they also take advantage of gaps in the tax law to provide investors with tax deferral (of up to 30 years) and character conversion

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[4] *See*, e.g., Letter of May 15, 1991, from Jere D. McGaffey to Fred T. Goldberg, Jr. (transmitting comments prepared by members of the ABA's Section of Taxation on the application of market discount rules to speculative bonds).

[5] *See*, e.g., Institute letter to Eric Solomon and Donald Korb, dated July 28, 2008.

[6] *See* Institute letter to Greg F. Jenner and Donald L. Korb, dated July 21, 2004.

[7] *See* Institute letter to Eric Solomon and Donald L. Korb, dated May 13, 2008. See also, Testimony of William M. Paul on behalf of the Institute, presented on March 5, 2008 before the House Ways and Means Subcommittee on Select Revenue Measures. http://waysandmeans.house.gov/hearings.asp?formmode=view&id=6824.

that is inappropriate. This treatment is far more favorable than the treatment obtained by investors in comparable financial instruments and provides a tax incentive to take on issuer credit risk (rather than invest in products that do not entail this risk). In the absence of legislation, regulations should be issued under Treasury's existing authority under section 1260 and should provide a mark-to-market election. If a comprehensive regulatory approach is not developed under section 1260, guidance should be issued under section 446 to address any ETNs that remain outside the scope of the section 1260 constructive ownership solution.

II. Items Deleted from the 2009-2010 Guidance Priority List

A number of items affecting RICs and their shareholders were deleted from the 2009-2010 Priority Guidance List without guidance being issued. Legislation introduced in the House of Representatives in 2009 (H.R. 4337, the Regulated Investment Company Modernization Act of 2009) effectively would resolve two concerns that would have been addressed by items on prior Guidance Priority Lists:

- the application of section 1(h) to RIC capital gain dividends[8] and similar bifurcation-related issues arising under section 871(k)(2), which permits flow-through of short-term capital gain dividends; and

- minor errors made by RICs, such as mathematical, computer and processing errors that may create preferential dividends.[9]

We urge the Treasury Department's support for this important legislation[10] and the issuance of any post-enactment guidance that might be necessary. Should additional issues arise relating to capital gain dividends or minor errors, we will request guidance addressing them.

The ICI also urges the IRS and Treasury to address issues regarding section 529 qualified tuition programs ("section 529 plans"). A project to address these issues, which was included on prior Guidance Priority Lists, similarly was deleted from the 2009-2010 list without guidance being issued. Guidance regarding section 529 plans remains necessary to implement fully the Advance Notice of Proposed Rulemaking ("Advance Notice") regarding section 529 plans that the IRS released in 2008. We are pleased that the Advance Notice reflects several comments previously submitted jointly by the

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[8] *See* e.g., Institute letter to Alice Bennett, dated May 24, 2006.

[9] *See* Institute letter to Eric Solomon and Donald L. Korb, dated September 12, 2008.

[10] The RIC Modernization Act legislation also would address several other issues that have been included in prior ICI letters requesting items for the Guidance Priority List. These items include: (1) treating all redemptions of mutual fund shares as not being essentially equivalent to a dividend; (2) addressing certain "flow-through" issues for funds of funds; and (3) providing automatic extensions to file IRS Forms 1120-RIC.

Institute and the Securities Industry and Financial Markets Association ("SIFMA").[11] It remains important, for those saving for education through section 529 plans, that the tax treatment of investments in such plans be clear. We urge the IRS to continue its work on this guidance project to address outstanding issues.[12]

III. Other Issues Directly Affecting RICs and Their Shareholders[13]

A. The Application of General Corporate Tax Rules to RICs

The Institute requests that the IRS and Treasury address issues arising from the application of the general corporate tax rules to RICs. These rules can be unnecessarily difficult to apply and can result in unintended consequences.

1. Business Continuity Requirement for Tax-Free Mergers

First, the Institute requests guidance clarifying the application of the "business continuity" requirement to RICs under section 368 and Treas. Reg. § 1.368-1(d)(2).[14] This clarification is necessary because it is difficult to discern the intended scope of the business continuity test as applied to RIC reorganizations. As a result, many RICs engaging in merger transactions are compelled to rely on the "asset continuity" test;[15] this test, to the detriment of the RIC's shareholders, can place artificial limits on the ability of a portfolio manager to dispose of portfolio securities acquired from a target RIC and imposes significant compliance burdens on funds. This issue has become increasingly important given recent financial conditions, under which more and more RICs are being merged. The Institute requested guidance on this issue in 2004, at which point the IRS informed us that they wished to gather more information on RIC mergers through the private letter ruling process. The Institute hopes that the IRS and Treasury now have sufficient information to open a project on this issue and requests that they do so.

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[11] *See* Institute and SIFMA letter to Michael Desmond, dated June 12, 2007.

[12] *See* Institute letter to Richard Hurst, Mary Berman and Monice Rosenbaum, dated May 12, 2008, for comments regarding the Advance Notice.

[13] At this time, we are not requesting a further extension of Notice 2008-55 (relating to auction rate preferred stock). Should the market conditions persist that necessitated the extension of Notice 2008-55 (provided by Notice 2010-3), we will make a separate request.

[14] *See* Institute letter to William D. Alexander and Lon B. Smith, dated January 15, 2003. *See also* Institute letter to William D. Alexander, dated April 30, 2004.

[15] *See* Treas. Reg. § 1.368-1(d)(3).

2. Ownership Tracking Requirements

Second, the Institute asks that a project be opened to amend the regulations under sections 382 and 383 with respect to ownership tracking requirements that apply to participant-directed retirement accounts holding RIC shares and to variable insurance products. Specifically, the regulations should permit a RIC to look through participant-directed retirement accounts and variable insurance product account owners and treat each participant/investor who holds less than five percent of the RIC's shares as part of the RIC's direct public group. The concerns against which sections 382 and 383 are directed are not implicated when a RIC's new shareholders are retirement accounts or variable insurance product accounts that cannot benefit from such tax attributes.

This change effectively would prevent a large collection of small investors making independent investment decisions from being treated as a single entity for ownership change purposes. Absent this change, a retirement plan administrator's decision as to what RICs to offer in a plan could significantly affect whether other shareholders in the RIC can benefit from the RIC's capital losses even though the retirement plan administrator is neither a beneficial owner of RIC shares nor responsible for allocating investment assets among RICs. Likewise, absent this change, an ownership change could occur if another company buys the insurance company holding the variable insurance product shares.

B. RIC Portfolio Investments

The Institute requests guidance on several issues arising from RICs' portfolio investments.

1. PFICs

First, we ask the IRS and Treasury to issue additional guidance regarding passive foreign investment companies ("PFICs"). The preamble to the final PFIC mark-to-market regulations (TD 9123) published on April 29, 2004, notes in three places that comments received relating to the impact of the PFIC rules on RICs were beyond the scope of that regulations project.[16] We request that a regulations project be opened to address these and other PFIC-related issues faced by the industry.

Specifically, the Institute requests guidance providing (i) that gains from dispositions of former PFIC stock are capital while losses are ordinary to the extent of prior unreversed inclusions; (ii) RICs with automatic consent to terminate a section 1296 election during a non-PFIC year; (iii) that RICs may recognize any change in PFIC status of a foreign corporation for the RIC's taxable year within which the taxable year of the foreign corporation ends; (iv) that the consequences to RICs of applying former Prop. Treas. Reg. § 1.1291-8 will be respected, where relevant, for purposes of section 1296; and (v) that RICs may determine qualified electing fund ("QEF") inclusions using audited financial statements that were prepared using U.S. Generally Accepted Accounting Principles

[16] *See* Institute letter, dated November 22, 2002, and Institute letter to Dale S. Collinson, dated April 24, 2003.

or International Financial Reporting standards, and that all QEF inclusions subject to this election will be treated as ordinary, but retain the capital character of disposition gains and losses.

2. RIC Investments in Partnerships with Different Taxable Year-Ends

Second, we request guidance regarding RIC investments in a partnership in which the RICs and the partnership have different tax years; this guidance should allow RICs to take partnership items into income at the end of each month, rather than at year-end. In general, partners must take partnership items into account at the end of the partnership's tax year. If a RIC invests in a partnership with a different tax year, however, this can cause mismatches between the RIC's distributions and the amount of earnings and profits associated with the partnership's income.

3. Taxable Mortgage Pools

Third, we request regulatory guidance to clarify issues relating to excess inclusion income of a REIT that is a taxable mortgage pool ("TMP") or that has a qualified REIT subsidiary that is a TMP. While Notice 2006-97[17] addressed a few issues, and responded to some of the Institute's concerns with the lack of guidance in this area,[18] many critically important issues remain unresolved. At a minimum, and as requested by the Institute in 2006, guidance should be issued stating that Notice 2006-97 will not be applied until some reasonable period after a practical reporting regime is implemented and the many uncertainties arising from the Notice are resolved.[19]

C. Information Reporting

The Institute also asks the IRS and Treasury Department to issue guidance on several important reporting issues affecting RICs and their shareholders.

1. Uncertain Tax Positions

The Institute urges the IRS to exempt from Schedule UTP reporting those tax positions for which a FIN 48 liability is not recorded because of administrative practice.

2. TIN Masking

Second, the Institute asks the IRS and Treasury Department to make permanent its pilot program permitting information return filers to "mask" (or obscure) the full Social Security number on Forms 1099 and 5498 mailed to investors, with the changes suggested by the Institute.[20] Masking

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[17] 2006-2 C.B. 904.

[18] *See* Institute letter to Eric Solomon and Donald L. Korb, dated May 12, 2006.

[19] *See* Institute letter to Lon B. Smith, dated December 29, 2006.

[20] *See* Institute letter regarding Notice 2009-93, dated April 30, 2010.

or obscuring the full taxpayer identification number is the most effective way to combat identity theft, and many RICs already do so on non-tax documents sent to shareholders. We believe the pilot program is an important step towards minimizing situations in which taxpayers' personal information may be misappropriated from tax forms and, therefore, should be continued.

IV. Foreign Bank and Financial Account Reporting

Finally, we urge the IRS to make permanent its recent guidance regarding Form TD F 90-22.1, the Foreign Bank and Financial Accounts Report ("FBAR"). Specifically, Notice 2010-23 provides that a taxpayer with signature authority over, but no financial interest in, a foreign financial account, and who has no other reportable foreign financial accounts, should check the "no" box in response to FBAR-related questions on federal tax forms for 2009 and earlier years that ask about the existence of a financial interest in, or signature authority over, a foreign financial account. Requiring taxpayers with no financial interest in a foreign financial account to report such information is of no value to the IRS. Therefore, this guidance should be made permanent.

* * *

We will contact your offices shortly to request a meeting to discuss further these issues and their importance to the industry. In the meantime, if we can provide you with any additional information regarding these issues, please do not hesitate to contact me at (202) 326-5832 or lawson@ici.org.

Sincerely,

Keith Lawson
Senior Counsel – Tax Law

cc: CC:PA:LPD:PR (Notice 2010-43)
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Notice 2010-43

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June 8, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Recommendation for 2010-2011 Guidance Priority List

Dear Commissioner Shulman:

We respectfully request that the Internal Revenue Service (the "Service") and Treasury Department ("Treasury") publish Final Regulations under section 104(a)(2) of the Internal Revenue Code (the "Code") to clarify the scope of the exclusion for damages received on account of personal "physical" injuries or "physical" sickness.

On September 14, 2009, Treasury and the Service issued Proposed Regulations under Section 104(a)(2) to eliminate the requirement that damages received must be based upon "tort or tort-type" rights to be excluded from gross income. However, neither the Code, the Proposed Regulations nor formal guidance from the Service provide a definition of either "physical injury" or "physical sickness."

The boundary line between a physical injury and a nonphysical injury (such as purely emotional distress which the Proposed Regulations exclude from the scope of section 104(a)(2)) is not always clear. However, we believe the Final Regulations should clarify that two specific types of injuries qualify as ***per se*** physical injuries under section 104(a)(2).

Specifically, we request guidance that childhood sexual abuse cases and long-term wrongful incarceration (at least one year of restraint) are ***per se*** physical injuries under section 104(a)(2).

There is a significant body of literature that recognizes childhood sexual abuse as a serious medical problem with long lasting and severe physical manifestations, many of which can only be treated by a licensed medical practitioner or through the prescription of controlled medications. There are similar medical studies that demonstrate the persistent physical damage that results from long-term incarceration.

Appropriateness of Inclusion of Requested Section 104(a)(2) Guidance on the 2010-2011 Guidance Priority List.

Pursuant to Notice 2010-43, the Treasury and the Service consider the following in reviewing recommendations and selecting projects for inclusion on the 2010-2011 Guidance Priority list: (i) whether the recommended guidance resolves significant issues relevant to many taxpayers; (ii) whether the recommended guidance promotes sound tax administration; (iii) whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; (iv) whether the Service can administer the recommended guidance on a uniform basis; and (v) whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

It is respectfully submitted that the requested section 104(a)(2) guidance satisfies each of the criteria enumerated above. Since the amendment to section 104(a)(2) in 1996, taxpayers have been in need of guidance to determine the scope of the terms "physical injury" and "physical sickness." The application of section 104(a)(2) to the victims of childhood sexual abuse and wrongful incarceration affects a large and growing number of taxpayers, in the former case because of greater opportunities for victims to come forward after legislation in many states which extends applicable statutes of limitations and in the latter case because of more widely available DNA-testing to absolve wrongfully convicted prisoners. The requested section 104(a)(2) guidance would promote sound tax administration by providing an understandable tax rule for these victims, thereby minimizing the likelihood of future controversies. It would also provide consistency in tax treatment among such victims who face uncertainties and expense as they attempt to address the issue in an individualized basis.

We would appreciate the opportunity to discuss this issue with you and others from the Service and Treasury. If you have any questions or would like additional information, please contact us at (630) 922-8830. Thank you in advance for your consideration of this request.

Respectfully submitted,

David Shechtman
Drinker Biddle & Reath

John McCulloch
Integrated Financial Settlements

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 14 2010

Johnson Regina

From: Glass, Rich [rglass@infinisource.net]
Sent: Friday, May 14, 2010 9:56 AM
To: Notice Comments
Subject: Recommendations for 2010-2011 Guidance Priority List (Notice 2010-43)

To Whom It May Concern:

Infinisource, Inc. would like to provide recommendations for the 2010-2011 Guidance Priority List. This is in response to the request in Notice 2010-43 (www.irs.gov/pub/irs-drop/n-10-43.pdf).

As a benefits and payroll third party administrator, Infinisource assists more than 15,000 employers with compliance issues relating to rules over which IRS has jurisdiction. The following is a list of significant issues on which guidance would be beneficial to many employers:

- **Guidance under §4980B regarding calculation of the applicable premium for COBRA continuation coverage for HRAs.** This law was enacted long before HRAs were effectuated. Employers struggle with making an accurate determination of the correct COBRA premium, particularly with the reasonable actuarial method, which is supposed to take into account "factors as the Secretary [of Treasury] may prescribe in regulations."
- **Application of Michelle's Law to COBRA.** The interaction of these two laws has never been clear, particularly as to when a loss of coverage occurs. Our understanding is that Michelle's Law may have been rendered obsolete by the Affordable Care Act. Confirmation of this fact would be beneficial.
- **Finalization of the Cafeteria Plan Regulations.** There are several questions related to these regulations, including how the substantiation rules apply outside of a debit card context and some questions regarding nondiscrimination testing and the NDT safe harbor. Finalization of these regulations would bring welcome clarity and ensure uniform administration.
- **Potential HIPAA and COBRA Issues for Paying for Individual Coverage Through a Cafeteria Plan.** While the Proposed Cafeteria Plan Regulations allow such payments, it is unclear how and if an employer may be liable under HIPAA (relating to nondiscrimination) and COBRA (if a qualifying event occurs).
- **Dependent Care Assistance Plan Nondiscrimination Testing Rules.** Employers struggle to apply these statutory rules, particularly the 55% Average Benefits Test. Regulatory guidance would enable employers to perform these tests more accurately.

We thank you for your consideration of these issues.

Rich Glass, JD
Chief Compliance Officer
Infinisource, Inc.
866-350-3040, x. 1465
www.infinisource.net

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

JUN 1 1 2010

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June 11, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Recommendation for 2010-2011 Guidance Priority List – Notice 2010-43

To Whom It May Concern:

The Information Reporting Program Advisory Committee (IRPAC)[1] appreciates the opportunity to recommend items that should be included on the 2010-2011 Guidance Priority List. We request that the Internal Revenue Service (IRS) update its guidance on last known addresses specifically related to business addresses.

IRS Revenue Procedure 2010-16 provides an explanation of how IRS is informed of a change of address. The address of record is crucial as it is the address used for all correspondence including but not limited to notices and refunds of overpayment of taxes.

Many businesses have multiple locations with various functions, e.g. payroll, income tax, information reporting etc, that file returns and receive correspondence from the IRS. Under the current system and processes, the address of record changes each time a return is filed by any of those functions. The end result is notices and correspondence are misdirected within each of those affected companies. That results in errors anywhere from unresolved B-notices to misdirected refunds.

The following are some of examples where this has proved problematic:

- A large bank's payroll tax department received B-Notices for the bank's Form 1099 processing unit
- An outsourced payroll service received notices for a firm's corporate tax obligation

[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

- A bank's customer, who mistakenly used the bank's address and EIN on a nominee Form 1099, received the banks IRS correspondence

Background

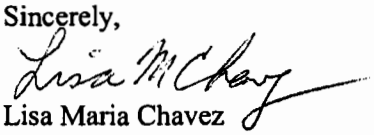
The IRS Business Master File is the repository for Name and Address information for all of the registered business entities within the United States. The current technology employed by IRS only allows one entry for each registered business. Rev. Proc. 2001-18 outlined the IRS process and recently released Rev. Proc 2010-16 provides updated guidance including procedures for electronic and oral address changes. Both revenue procedures apply to individuals as well as businesses and provide the same treatment for both. An increasing number of businesses have decentralized processes causing a greater number of cases of misdirected communication. Historically, when more businesses operated out of one address, the consistent process between individuals and businesses was acceptable. However, through acquisitions and decentralization, this model no longer works.

Recommendations

- IRS should immediately update Revenue Procedure 2010-16 to separate last known address processes between businesses and individuals. For example: current procedure requires that the entity disclose the old address in order to make a change. However, since many businesses have multiple locations the business has no way of knowing which address is on the Business Master File (BMF) record.
- IRS should allow for an indicator on each company's BMF record. That indicator would lock the contact and address information unless an authorized change is made using Form 8822
- Alternatively, IRS should pursue an option where each business form includes a check box that can be used by businesses to indicate that the address should be changed.
- In the event IRS is not able to accommodate the previous recommendations, IRS should consider allowing businesses to opt out of the current procedure of automatic address change with each tax filing. In this case, the business would be required to file Form 8822 to change their business address.
- IRS should accelerate the development of a system that allows for multiple addresses and contacts. The system should also include the ability to directly associate that information with specific IRS functions.

Thank you for your attention to this matter. We look forward to working with IRS to resolve this issue. If you have any questions, please contact the undersigned.

Sincerely,



Lisa Maria Chavez
2010 IRPAC Chair

Notice 2010-43

LEGAL PROCESSING DIVISION
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JUN 14 2010

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June 11, 2010

Submitted electronically via e-mail to
Notice.Comments@irscounsel.treas.gov

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2010-43
Invitation to Comment on the 2010-2011 Guidance Priorities
Recommendation to Include Changes to the Conformity Election

Gentlemen:

I appreciate the Service's invitation in Notice 2010-43 to provide recommendations for items that should be included on the 2010-2011 Guidance Priority List.

Recommended New Guidance - As discussed in more detail below, I recommend that the Service include an update to the Conformity Election by financial institutions for the deduction of bad debt losses. This recommendation would involve at least:

- Revisions to Regulation Section 1.166-2(d)(3).
- Revisions to Revenue Procedure 92-84.
- A new Revenue Procedure permitting an automatic perfection of technically invalid Elections.

Why New Guidance is Needed - The Conformity Election was adopted as a Final Regulation in Treasury Decision 8396, dated February 24, 1992. At the same time, the Service issued Revenue Procedure 92-18 with the form and content of the Express Determination Letter that a bank must obtain from its supervisory authority to qualify for the Election. The supervisory authority must

determine that the bank maintains and applies the proper loan review and classification standards. The Express Determination Letter was modified in Revenue Procedure 92-84.[1]

Many of the larger banks made the Conformity Election shortly after the adoption of the Final Regulation, or after the publication of Revenue Ruling 2001-59 clarifying the determination of whether a charge-off has been classified as a "loss asset."

However, it is my observation that many smaller community banks, probably the majority, still have not made the Conformity Election, now 18 years after the adoption of the Final Regulation.[2] Most community banks avoided the Election for many years for a number of reasons, none of which continue to apply. Now that community banks are attempting to make the Election in substantial numbers, it is also my observation that many of the Elections that have been made are technically invalid.[3]

The Conformity Election was an outstanding effort by the Service to both clarify and simplify a growing and difficult issue for bank taxpayers during the 1980s.

Recall that the Election came after the widespread credit crisis during the 1980s when banks incurred major losses on agricultural and energy loans, and many banks failed. The banks found themselves] between the federal examiners who were aggressively ordering higher reserves and loan charge-offs, and IRS examiners whose focus was whether the charge-offs were truly loss assets. The Conformity Election was a logical approach to end this stand-off. The Election enables taxpayers to more accurately determine taxable income and conserves the Services' examination resources.

During approximately the same period of time, the banking industry experienced considerable consolidation as banking became less local and more regional and national. The larger regional and national banks were encountering a different issue with their bad debt losses. With their increasing size, and their ever widening branch network, it was becoming increasingly difficult to identify the specific loans charged-off in the branches, or to accumulate the loan information required by IRS examiners to determine that the charge-offs all related to loss assets. The federal banking examiners were already examining the banks' policies and procedures for loan management. In the interest of conserving both the taxpayers' and the Service's resources, the Service initiated the Conformity Election to avoid duplication of efforts.

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[1] Revenue Procedure 92-84 superceded Revenue Procedure 92-18.

[2] I continue to receive numerous requests for a copy of the Express Determination Letter. It is explained to me that when asked for the letter by a bank intending to make the Conformity Election, the federal field examiner in charge has responded that he/she has "no idea" what the bank is requesting, and has never seen one of these letters. While my experience is antidotal, it does illustrate the relative rarity of the Election among the smaller banks for which these particular field examiners have responsibility.

[3] This observation is discussed further below.

The evolution of the banking agencies' examination practices, and banks' experience with a greater volume of Elections, suggests that some updating needs to be done for the Conformity Election to continue to achieve the Service's objectives.

Evaluation Criteria. In Notice 2010-43, the Service listed five criteria for evaluating topics for its guidance priorities.

1. Whether the recommended guidance resolves significant issues relevant to many taxpayers.

   The Conformity Election potentially affects all financial institutions in some way or another. The FDIC financial institution directory states that there were 7,888 insured financial institutions as of June 3, 2010.

2. Whether the recommended guidance promotes sound tax administration.

   My recommendation to revise the rules around the Conformity Election (a) does not introduce any new concept to tax administration, and (b) will encourage an expanded use of this important administrative initiative by the Service.

3. Whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance.

   With one exception (a new Revenue Procedure for automatic perfection of inadvertently invalid Elections), my recommendations are relatively minor revisions to existing guidance that will remove uncertainty that exists with the current guidance. The proposed new Revenue Procedure will not be difficult to draft or understand. While the subjects are quite different, there are several existing Revenue Procedures in the S corporation area which may serve as conceptual models for the proposed Procedure.

4. Whether the Service can administer the recommended guidance on a uniform basis.

   My recommendations will make the existing guidance easier to administer on a uniform basis.

5. Whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

   The purpose of the Conformity Election was to reduce controversy and conserve the resources of both taxpayers and the Service. My recommended revisions will cause more banks to make the Election, making the Election more effective.

Issues to Address

When is the First Express Determination Letter Required? - It has not been easy for banks, and their professional advisers, to determine when the first Express Determination Letter is required. Regulation Section 1.166-2(d)(3)(iii)(C)(1) states in relevant part:

> "The ... Form 3115 must ... contain a declaration that the express determination requirement of paragraph (d)(3)(iii)(D) of this section *is satisfied for the taxable year of the election.*" [italics added]

The standard wording of the Express Determination Letter is in Revenue Procedure 92-84 and reads in relevant part:

> "In connection with the most recent examination of [name of bank], by [name of supervisory authority], as of [examination date], we reviewed the institution's loan review process as it relates to loan charge-offs. Based on our review, *we concluded that the bank, as of that date*, maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs." [italics added]

Note that the Express Determination Letter is as of the examination date, and that the examiners' conclusion is "as of that date." The Express Determination Letter does not cover the period from the previous examination to the current examination. Rather, it is a "snap shot" as of the examination date.

The Regulation requires that the Express Determination Letter requirement be "satisfied for the taxable year of the Election." Accordingly, for the bank to have an Express Determination Letter for the full taxable year for which the Election is made, the first Express Determination Letter would appear to be needed for the last federal examination date *prior to the beginning of the taxable year.* A representative of the Service who is familiar with the Conformity Election has concurred orally with this analysis.

This requirement creates a very difficult logistics problem. I understand that since the Regulation was issued in 1992, the federal banking examiners have changed their examination cycles to 18 months. Accordingly, for a bank using the calendar tax year to make the Conformity Election for 2010, it may have needed to have obtained the Express Determination Letter as early as an examination date in July 2008, and certainly some time in 2009. This timing issue has become a material deterrent to making the Election.[4]

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[4] I continue to hear from CPAs that the timing issue is sometimes complicated by some field examiners' reluctance to provide the Express Determination Letter unless the bank has made the Election, or at least represents that it will make the Election in the current year. This is not a universal issue, but it is one that could be mitigated by my suggestion below that the updated Revenue Procedure 92-84 specifically observe that the Express Determination Letter does not have to be rendered at the completion of the examination.

In addition, many advisers have not appreciated the nuances described above. They have believed that the letter was not needed until a federal examination during the year that the Election was made, resulting in numerous technically invalid Elections.

The examination process is actually a somewhat "mixed" process. On the one hand, the examination is as of a specified date, usually when the field work begins. The form Express Determination Letter includes that date. On the other hand, the examiners take notice of changes and developments in the bank's policies and procedures since the previous examination. Accordingly, the Service does not need for the bank to obtain an Express Determination Letter for examinations before the election year. An Express Determination Letter for an examination during the election year, or even shortly after the election year if necessary, is actually more relevant than an earlier examination before the beginning of the election year to assure the Service that the bank maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs during the taxable year of the Election.

The Service would encourage more community banks to make the Conformity Election if the first Express Determination Letter were required for the first examination date *after* the beginning of the year for which the Election is effective, rather than the first examination *before* the beginning of the year. I recommend that Regulation Section 1.166-2(d)(3)(iii)(D) be revised to read somewhat as follows:

> "(D) Express determination requirement. In connection with its ~~most recent~~ first examination involving the bank's loan review process after the beginning of the tax year for which the election is made, the bank's supervisory authority must have made an express determination (in accordance with any applicable administrative procedure prescribed hereunder) that the bank maintains and applies loan loss classification standards that are consistent with the regulatory standards of that supervisory authority. For purposes of this paragraph (d)(3)(iii)(D), the supervisory authority of a bank is the appropriate Federal banking agency for the bank, as that term is defined in 12 U.S.C. 1813(q), or, in the case of an institution in the Farm Credit System, the Farm Credit Administration."[5]

May the Express Determination Letter be obtained after the examination is completed? It is my observation from conversations with CPAs who advise banks and thrifts throughout the country that there is little consistency among field bank examiners whether they will issue an Express Determination Letter as of a previous examination date if the letter was not requested during the examination. More often, field examiners are not willing to issue a letter after the examination is finished.

The Service's interest is whether the bank examiners were satisfied as of the examination date that the bank maintained and applied loan loss classification standards that were consistent with

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[5] Throughout this letter, proposed new language is in red and language proposed to be removed is in red and overstruck.

regulatory standards regarding loan charge-offs. If the bank examiners were satisfied with the bank's loan loss classification standards, that will be clear to them from their workpapers. If they were not satisfied with the bank's classification standards, that will also be clear in the workpapers and will be mentioned in the examination report. Of course, it would be nice for the Express Determination Letter to be contemporaneous with the examination report, but there is no tax imperative for it to be so.

In practice, whether to make the Conformity Election is discussed by the bank with its professional advisers either in the pre-year end financial review and/or preliminary audit work, or during preparation of the income tax return. I am confident that more community banks would make the Conformity Election if it is made clear that there is no objection to the bank field examiner providing the Express Determination Letter after the examination is finished, based on the examination files.

I recommend that Section 4.01 of Revenue Procedure 92-84 be revised to read as follows:

> "SEC. 4. PROCEDURE. 01 An express determination within the meaning of section 2.03 of this revenue procedure and section 1.166-2(d)(3) of the regulations is a letter that is provided by the bank's supervisory authority as defined in section 1.166-2(d)(3)(iii)(D), either contemporaneously with the examination report or before the next succeeding examination. The letter ~~that~~ is separate and distinct from the examination report, ~~that~~ is signed and dated as of the date rendered by the examiner in charge, and ~~that~~ contains the following statement: ..."

Declaration regarding the Express Determination Letter on the Form 3115. I have quoted above the requirement in Regulation 1.166-2(d)(3)(iii)(C)(1) that the Form 3115 include a declaration that the Express Determination Letter requirement is satisfied for the taxable year of the Election. Unfortunately, the Regulation goes on to state that the declaration is made in the space provided on the form for "Other changes in method of accounting." Subsequent revisions to the Form 3115 have eliminated that space from the form. As a result, it is my observation that banks and their advisers tend to overlook the declaration requirement because there is no place on the current Form 3115 to make it. In addition, the current content of Form 3115 does not alert the preparer to either the possible issue with the declaration or the date for which the Express Determination Letter is required.

The result is a substantial number of Conformity Elections which are technically invalid because they do not include the declaration.

I recommend that the Service delete the "declaration " requirement from the Regulation, and in lieu of the declaration, revise Form 3115 to include a separate schedule for the Conformity Election. The Form 3115 schedule should include a question regarding the first examination date for which the Express Determination Letter was obtained.

Must a copy of the Form 3115 be sent to the IRS National Office? The existing guidance appears to provide that a copy of the Form 3115 is not required to be filed with the National Office. However, because banks have only one opportunity in the entire life of the bank to make an automatic Conformity Election, caution requires that CPAs advise their clients to file a copy of the Form 3115 with the National Office whether or not the bank is actually required to do so.

Section 6.02(3) of Revenue Procedure 2008-52 reads in relevant part:

> "(3) Timely duplicate filing requirement. (a) In general. A taxpayer changing a method of accounting pursuant to this revenue procedure must complete and file an application in duplicate. The original must be attached to the taxpayer's timely filed (including any extension) original federal income tax return for the year of change, and a copy (with signature) of the application must be filed with the national office (see section 6.02(7) of this revenue procedure for the address) no earlier than the first day of the year of change and *no later than when the original is filed with the federal income tax return for the year of change*. ..." [italics added]

The instructions to Form 3115 state in the section captioned "When and Where to File"

> "Automatic change requests. A Form 3115 that is filed under the automatic change request procedures is filed in duplicate. The original must be attached to the filer's timely filed (including extensions) federal income tax return for the year of change. A copy of the Form 3115 must be filed with the IRS National Office (see below) no earlier than the first day of the year of change and no later than when the original is filed with the federal income tax return for the year of change."

On the other hand, the Regulation has no requirement to file a copy of the Form 3115 with the National Office. Regulation 1.166-2(d)(3)(iii)(C)(2) states in relevant part:

> "(2) First election. The first time a bank makes this election, the statement or Form 3115 must be attached to the bank's timely filed return (taking into account extensions of time to file) for the first taxable year covered by the election. The consent of the Commissioner to make a change in method of accounting under this paragraph (d)(3) is granted, pursuant to section 446(e), to any bank that makes the election in accordance with this paragraph (d)(3)(iii)(C), provided the bank has not made a prior election under this paragraph (d)(3))."

The Form 3115 instructions for the Conformity Election also suggest that a copy is not required to be filed with the National Office. The instructions state in relevant part:

> "**6. Bad debt conformity for banks (section 166)** - Banks, other than new banks, to the method that conforms to section 1.166-2(d)(3) for the first time the bank makes this change, or to involuntarily revoke this method. This does not fall under the procedures of Rev. Proc. 2002-9. *Instead, see Regulations section 1.166-2(d)(3).*" [bold and italics in original]

If we substitute Revenue Procedure 2008-52 for Revenue Procedure 2002-9, then the instructions would indicate that the duplicate filing requirement of Revenue Procedure 2008-52 do not apply.

I recommend that the Service clarify this question by revising the Regulation Section 1.166-2(d)(3)(iii)(C) to read somewhat as follows:

> "(C) Procedures. (1) In general. A new bank adopts the method of accounting under this paragraph (d)(3) for any taxable year ending on or after December 31, 1991 (and for all subsequent taxable years) when it adopts its overall method of accounting for bad debts, by attaching a statement to this effect to its income tax return for that year.
>
> (2) Any other bank makes an election for any taxable year ending on or after December 31, 1991 (and for all subsequent taxable years) by filing a completed Form 3115 (Application for Change in Accounting Method) in accordance with the Revenue Procedures then applicable to automatic changes of accounting methods and the then current instructions to Form 3115, except that no Copy of Form 3115 is filed with the IRS National Office. ~~the rules of paragraph (d)(3)(iii)(C)(2) or (3) of this section. The statement or Form 3115 must include the name, address, and taxpayer identification number of the electing bank and contain a declaration that the express determination requirement of paragraph (d)(3)(iii)(D) of this section is satisfied for the taxable year of the election) When a Form 3115 is used, the declaration must be made in the space provided on the form for "Other changes in method of accounting." The words "ELECTION UNDER section 1.166-2(d)(3)" must be typed or legibly printed at the top of the statement or page 1 of the Form 3115.~~

The instructions to Form 3115 could be similarly revised to state that no copy is filed with the IRS National Office.

If the National Office concludes that it does need to receive these Forms 3115, then the requirement to file a copy of the Form can be clarified by deleting the except from the above revision.

One chance to make a valid Election. Regulation 1.166-2 provides only one chance in the entire life of a bank to make the Conformity Election automatically, and without a user fee. Regulation 1.166-2(d)(iii)(C)(3) states:

> "(3) Subsequent elections. The advance consent of the Commissioner is required to make any election under this paragraph (d)(3) after a previous election has been revoked pursuant to paragraph (d)(3)(iv) of this section. This consent must be requested under the procedures, terms, and conditions prescribed under the authority of section 446(e) and section 1.446-1(e) for requesting a change in method of accounting."

There is no five year waiting period to remake the Election similar to other automatic changes.

I have discussed orally with a representative of the Service whether an Election without the Express Determination Letter in hand, or filing Form 3115 without attaching the declaration regarding the Express Determination Letter, will be disregarded. I reasoned that if the attempted Election was invalid on its face, then no election was made and a subsequent Form 3115 was the "first election."

I was told that the invalid Election is treated as an election which has been revoked. Accordingly, any subsequent Election, during the entire life of the bank, must be made with the approval of the National Office and is subject to the user fee.

The "once in a lifetime" rule can also complicate changes of control. If the acquired bank has ever revoked a Conformity Election, or had the Election automatically revoked, then the acquirer may not make an automatic Election for the acquired bank, even if all of its other bank subsidiaries are already subject to Conformity Elections. This kind of inconsistency is not in the interest of the Service.

In the interest of conserving the Service's resources, avoiding controversy, and maximizing the number of Conformity Elections, I recommend that the Service take several actions:

- Issue a Revenue Procedure permitting the perfection of a Conformity Election that was inadvertently invalid when it was made.[6]

- Revise the Regulation to permit a new automatic election after a change of control or after five years, and to disregard elections which are invalid when made and which have not been perfected. A new subparagraph (4) should be added to Regulation Section 1.166-2(d)(3)(iii)(C) that reads somewhat as follows:

> "(4) Special rules. For purposes of this subparagraph (C), an election shall be considered a first election if (a) there has been a change of control of the bank after a previous election was either voluntarily or involuntarily revoked, (b) a previous election was voluntarily or involuntarily revoked at least five taxable years before the year for which the new election is made, or (c) a previous attempted election was invalid when it was made. For this purpose, a change of control occurs when there is a change of ownership as if Section 382 applied."

- Change Regulation Section 1.166-2(d)(3)(iv)(C) to Section 1.166-2(d)(3)(v) and revise it to read somewhat as follows:

> "(~~C~~v) Automatic ~~revocation~~ suspension. ~~(I) In general.~~ A bank's election under this paragraph (d)(3) is ~~revoked~~ automatically suspended if, in connection with any examination involving the bank's loan review process by the bank's supervisory authority

[6] This Revenue Procedure would be similar in purpose to Revenue Procedures 97-48, 2003-43, 2004-35, 2004-48, 2004-49, and 2007-62 for perfecting various defects in S corporation, entity classification, and/or QSub elections.

as defined in paragraph (d)(3)(iii)(D) of this section, the bank does not obtain the express determination required by that paragraph.

"(~~2~~1) ~~Year of revocation~~ Suspension period. If a bank makes the conformity election under ~~the transition rules of paragraph (d)(3)(iii)(E) of~~ this section and does not obtain the express determination in connection with ~~the first~~ any subsequent examination involving the bank's loan review process ~~that is after October 1, 1992~~, the election is ~~revoked~~ suspended as of the beginning of the taxable year which includes the examination date, and such suspension continues until such subsequent examination date with respect to which the express determination is obtained. ~~of the election or, if later, the earliest taxable year for which tax may be assessed. In other cases in which a bank does not obtain an express determination in connection with an examination of its loan review process, the election is revoked as of the beginning of the taxable year that includes the date as of which the supervisory authority conducts the examination even if the examination is completed in the following taxable year.~~

This suspension approach protects the interests of the Service in conforming charge-offs for income tax purposes with charge-offs for regulatory purposes, while also serving the Service's purpose to encourage as many Conformity Elections as possible.

Refusal of the federal bank examiners to issue an Express Determination Letter because charge-offs were too late. During the current credit crisis, I have begun to hear of instances in which the federal bank examiners refused to provide the Express Determination Letter because they were ordering the bank to make additional charge-offs at the conclusion of the examination. The examiners reasoned that if their examination results in additional charge-offs, then the bank must not be maintaining loan loss classification standards that are consistent with regulatory standards; i.e. their charge-offs are too late. The bank examiners' refusal to give the Express Determination Letter automatically revokes the bank's Conformity Election.

The Conformity Election was designed to deal with the change in banking practice from the old practice of waiting for an examination to take most charge-offs to a more pro-active program by the bank to take charge-offs as the loss assets are identified.[7] The Service's concern is not that charge-offs are too late, but rather than they are too early. If additional charge-offs are ordered by the federal bank examiners during the examination, those charge-offs should be covered by the presumption in Regulation 1.1662-2(d)(1)(i).

There is no guidance addressing this problem, except for one statement in Revenue Procedure 92-84 that, "For purposes of the express determination, any immaterial individual deviations from regulatory standards will not preclude a finding that a bank maintains and applies loan loss classification standards that are consistent with regulatory standards."

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[7] The bank examiners now criticize banks who wait for the examination to recognize charge-offs.

The difficulty that this creates for banks that have made the Conformity Election is that IRS examiners do not have a consistent or rational approach to the charge-offs which were made by the bank between examinations. I have been told of examinations during the current credit crisis in which the IRS field examiner has at least initially proposed that all of the interim charge-offs be disallowed because (i) they are not covered by a valid Conformity Election, and (ii) they were neither ordered by the bank examiners nor reviewed and approved by the bank examiners during the examination.

I recommend that Revenue Procedure 92-84 be updated to include a new alternative Express Determination Letter that reads somewhat as follows:

> "In connection with the most recent examination of [name of bank], by [name of supervisory authority], as of [examination date], we reviewed the institution's loan review process as it relates to loan charge-offs. Based on our review, and except for certain additional charge-offs which we conclude that the bank should have made before or as of the examination date, we concluded that the bank, as of that date, maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs.
>
> This statement is made on the basis of a review that was conducted in accordance with our normal examination procedures and criteria, including sampling of loans in accordance with those procedures and criteria. It does not in any way limit or preclude any formal or informal supervisory action (including enforcement actions) by this supervisory authority relating to the institution's loan review process or the level at which it maintains its allowance for loan and lease losses."

Charge-offs Required by the Bank Examiners to be Reflected in Periods Prior to the Examination Date - During the current credit crisis, the federal and state banking examiners are requiring banks to record charge-offs of loss assets in periods before the examination date, and to amend their Consolidated Reports of Condition and Income, or the equivalent filing by thrifts or other regulated corporations [popularly referred to as the Call Report].

In this situation, the Regulation clearly implies, but does not specifically direct, that the losses be deducted in the tax year(s) which include(s) the period(s) that the bank examiners require the losses to be reflected in the Call Reports. Regulation 1.166-2(d) reads in relevant part with respect to loans generally:

> "(d) Banks and other regulated corporations. (1) If a bank or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, charges off a debt in whole or in part, either (i) in obedience to the specific orders of such authorities, or (ii) in accordance with established policies of such authorities, and, upon their first audit of the bank or other corporation subsequent to the charge-off, such authorities confirm in writing that the charge-off would have been subject to such specific orders if the audit had been made on the date of the charge-off, then the debt

shall, to the extent charged-off during the taxable year, be conclusively presumed to have become worthless, or worthless only in part, as the case may be, during such taxable year. *But no such debt shall be so conclusively presumed to be worthless, or worthless only in part, as the case may be, if the amount so charged-off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which the charge-off takes place.* [italics added; see discussion below]

"(2) Evidence of worthlessness in later taxable year. If such a bank or other corporation does not claim a deduction for such a totally or partially worthless debt in its return for the taxable year in which the charge-off takes place, but claims the deduction for a later taxable year, then the charge-off in the prior taxable year shall be deemed to have been involuntary and the deduction under section 166 shall be allowed for the taxable year for which claimed, provided that the taxpayer produces sufficient evidence to show that (i) the debt became wholly worthless in the later taxable year, or became recoverable only in part subsequent to the taxable year of the involuntary charge-off, as the case may be; and, (ii) To the extent that the deduction claimed in the later taxable year for a debt partially worthless was not involuntarily charged-off in prior taxable years, it was charged-off in the later taxable year."

If the charge-off is not subject to the Conformity Election, the conservative tax treatment is to deduct the losses in the taxable year in which the bank is required to reflect the charge-offs in the Call Reports. First, that is responsive to the conclusive presumption language because the examiners will have specifically directed the bank regarding the Call Report in which to reflect the charge-off. Second, if the loss is not deducted in that year, subparagraph (2) places a special burden on the bank to produce sufficient evidence that the loan became partly or wholly worthless in the later year. This is a tall bar indeed given that the examiners have specifically chosen the Call Reports in which the bank is required to reflect the charge-offs.

The last sentence of subparagraph (d)(1) [in italics above] creates a real conundrum for the unfortunate bank which is examined after the tax return for the previous year is filed and the bank examiners require that certain losses be recorded in the prior year and that the Call Reports be amended. I am being told of some IRS field examiners who at least initially proposed that such losses were never deductible; (i) they could not be deducted in the prior year when recorded because they were not deducted in the original return, (ii) they could not be deducted in the current year because there was no charge-off in the current year and the bank could not show in the face of the examiners' report that they actually became worthless in the current year, and (iii) could not be deducted in a later year for the same reason. Carried to its logical conclusion, the bank would only be able to deduct the loss when the loan was finally "disposed of" through a settlement with the borrower or a foreclosure. This is not appropriate, and that sentence is not needed in light of current regulatory practice.

Finally, the reference in the Regulation to the examiners having reviewed charge-offs made by the bank between examinations is obsolete. When the Regulation was adopted, the bank examiners

reviewed all of the charge-offs taken by the bank since the previous examination. They stopped doing that many years ago.

If the bank has made the Conformity Election, Regulation Section 1.166-2(d)(3)(ii)(A)(ii)applies. It states in relevant part:

> "(ii) Conclusive presumption. (A) In general. If a bank satisfies the express determination requirement of paragraph (d)(3)(iii)(D) of this section and elects to use the method of accounting under this paragraph (d)(3), (1) Debts charged-off, in whole or in part, for regulatory purposes during a taxable year are conclusively presumed to have become worthless, or worthless only in part, as the case may be, during that year, but only if the charge-off results from a specific order of the bank's supervisory authority or corresponds to the bank's classification of the debt, in whole or in part, as a loss asset, as described in paragraph (d)(3)(ii)(C) of this section ... ."

The result for banks with the Conformity Election appears from this quote to be consistent with the result for banks which have not made the Election. Banks that have made the Conformity Election do not appear to have the same timing issue for examinations after the return is filed, but I am frequently asked about the application of Regulation Section 1.166-2(d)(3)(ii)(B), which states:

> "(B) Charge-off should have been made in earlier year. The conclusive presumption that a debt is worthless in the year that it is charged-off for regulatory purposes applies even if the bank's supervisory authority determines in a subsequent year that the charge-off should have been made in an earlier year. A pattern of charge-offs in the wrong year, however, may result in revocation of the bank's election by the Commissioner pursuant to paragraph (d)(3)(iv)(D) of this section."

This paragraph is difficult to interpret. If the federal or state examiners order the charge-off to be reflected in a Call Report for a year prior to the examination date, then it is "charged-off for regulatory purposes" in that earlier year. There is no charge-off in the year that includes the examination date to which the tax deduction may conform. However, what then is the meaning of the next to last sentence. I believe that it must cover those instances in which (i) the bank makes the charge-off and is not challenged by the bank examiners in that year, and (ii) the bank examiners later conclude during a subsequent examination that the loss should have been recorded in an earlier period, but (iii) the Call Reports are not amended. In that case, the conclusive presumption will apply and hold the year charged-off to be the correct year.

I believe that the interest of the Service in uniform application of the Regulation by taxpayer supports clarifying the Regulation to reflect current bank regulatory practices. I recommend that the Service clarify that losses are to be deducted in the years that they are reflected in the Call Reports or equivalent filings. Regulation Section 1.166-2(d)(1) should read somewhat as follows:

"(d) Banks and other regulated corporations. (1) If a bank or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, charges off a debt in whole or in part, ~~either (i)~~ in obedience to the specific orders of such authorities, ~~or (ii) in accordance with established policies of such authorities, and, upon their first audit of the bank or other corporation subsequent to the charge-off, such authorities confirm in writing that the charge-off would have been subject to such specific orders if the audit had been made on the date of the charge-off,~~ then the debt shall, to the extent charged-off during the taxable year, be conclusively presumed to have become worthless, or worthless only in part, as the case may be, during ~~such~~ the taxable year in which the examiners require the charge-off to be reflected in the bank's Consolidated Report of Condition and Income, or equivalent filing, as amended. ~~But no such debt shall be so conclusively presumed to be worthless, or worthless only in part, as the case may be, if the amount so charged off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which the charge-off takes place.~~

I further recommend that Section 1.166-2(d)(3)(B) be revised to read somewhat as follows:

"(3) Conformity election. ... (B) Charge-off should have been made in earlier year. The conclusive presumption that a debt is worthless in the year that it is reflected in the Consolidated Report of Condition and Income (or the equivalent filing), as amended, ~~charged off for regulatory purposes~~ applies even if the bank's supervisory authority determines in a subsequent year that the charge-off should have been made in an ~~earlier~~ different year, providing that either (a) the relevant Consolidated Reports of Condition and Income (or equivalent filings) are not amended, or (b) the statute of limitations is closed on the correct year as ultimately determined by the supervisory authority. A pattern of charge-offs in the wrong year, however, may result in revocation of the bank's election by the Commissioner pursuant to paragraph (d)(3)(iv)(D) of this section."

Tax Return Questions - Certain questions on Forms 1120 and 1120-S will greatly assist an IRS examining agent to efficiently prepare for an examination, and will also assist taxpayers' compliance by focusing their attention on key compliance issues. For example, I am frequently asked what to do if a bank which has made the Conformity Election simply forgets to request the Express Determination Letter during an examination. This is not as unusual as one might expect. Regulatory safety and soundness examinations are relatively intense, the bank employees focus on the facts relating to loans, and the bank's tax advisers are usually not involved. It is not uncommon for the bank's tax advisers to find out about the examination after it is finished, sometimes months after it is finished, especially if the examination went well. A question in the return regarding the Express Determination Letter will not permit that oversight to become stale. If my other recommendation regarding the issuance of Letters after the examination is completed is also adopted, many Conformity Elections would be saved.

I recommend that the Service consider adding four questions to the Forms 1120 and 1120-S as follows:

Is the taxpayer a regulated financial institution subject to the provisions of Regulation 1.166-2(d)?

(a) If the asnwer to __ is yes, has the taxpayer made the conformity election pursuant to Regulation 1.166-2(d)(3)?

(b) If the answer to (a) is yest:

(i) Taxable year for which the Conformity Election was first effective? _____

(ii) Date of the most recent federal examination involving the classification of loans for which an express determination was obtained? _____

Thank you for this opportunity to recommend a guidance topic. Please feel free to contact me to discuss my recommendation further or with any questions which you might have.

Very truly yours,

John E. Cederberg

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAY 17 2010

ALAN H. LEFF, CPA
alanleff@aol.com

5/12/10

DEAR SIR OR MS.

I AM A PRACTICING CPA THE IRS MUST INFORM CONGRESS TO STOP CHANGING THE LAWS FOR AT LEAST 2 YEARS SO THE IRS AND TAX PRACTITIONERS CAN CATCH UP. IT IS LUDICROUS THE LACK OF ~~AFFECT~~ UNDERSTANDING WE GET TO BE ABLE TO DO CAN DO BY THE LAWMAKERS

Alan H Leff CPA

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LEGAL PROCESSING DIVISION
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BRANCH

Notice 2010-43

JUN 1 2010

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June 1, 2010

VIA HAND DELIVERY
VIA ELECTRONIC MAIL

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Recommendation for 2010-2011 Guidance Priority List

To Whom It May Concern:

On behalf of American Express Company and pursuant to Notice 2010-43, 2010-22 I.R.B. 1, Miller & Chevalier Chartered respectfully requests that guidance pursuant to Section 4261(e)(3)(C) of the Internal Revenue Code as described below be included on the 2010-2011 Guidance Priority List.

Requested Guidance Pursuant to Section 4261(e)(3)(C)

Guidance is requested under Section 4261(e)(3)(C) regarding the application of the Section 4261(a) domestic air transportation excise tax to the purchase of mileage awards ("Section 4261(e)(3)(C) Guidance"). Specifically, such guidance should provide (i) that payments to air carriers for mileage awards are exempt from the excise tax to the extent the miles purchased are not to be used for "taxable transportation" (as defined in Section 4262); and (ii) a reasonable method (or methods) that may be used at the time mileage awards are purchased to determine the proper allocation between the amounts paid for mileage awards to be used for taxable transportation and those not to be used for taxable transportation (and, therefore, exempt from the excise tax). It is respectfully suggested that the Section 4261(e)(3)(C) Guidance be issued in the form of a notice or a revenue ruling.

Appropriateness of Inclusion of Section 4261(e)(3)(C) Guidance on the 2010-2011 Guidance Priority List

Pursuant to the Notice, the Treasury Department and the Internal Revenue Service (the "Service") consider the following in reviewing recommendations and selecting projects for inclusion on the 2010-2011 Guidance Priority list: (i) whether the recommended guidance resolves significant issues relevant to many taxpayers; (ii) whether the recommended guidance promotes sound tax administration; (iii) whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; (iv) whether the Service can administer the recommended guidance on a uniform basis; and (v) whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

It is respectfully submitted that Section 4261(e)(3)(C) Guidance satisfies each of the criteria enumerated above. The application of the Section 4261(a) excise tax to the purchase of mileage awards impacts the wide number of purchasers of mileage awards (including credit card companies, hotels, automobile rental companies and others), as well as the airline company sellers of such awards who bear ultimate liability for the tax. Section 4261(e)(3)(C) specifically authorizes rules to exclude from tax amounts attributable to mileage awards depending upon how such mileage awards are used. Since that provision was enacted in 1997, taxpayers have been in need of guidance to determine the appropriate amount of tax applicable to purchased mileage awards. To date, the scope of Section 4261(e)(3) has been the subject of lengthy and controversial examinations. *See, e.g.*, IRS Air Transportation Excise Tax - Audit Technique Guide. Section 4261(e)(3)(C) Guidance would help to resolve significant issues for a large number of taxpayers and promote sound tax administration by providing understandable rules which would apply the tax in a fair and equitable manner and to which both taxpayers and Service examiners could refer, thereby minimizing the likelihood of controversies and the burden on both taxpayers and the Service that they entail. It would also provide a consistency in approach, which for now may be lacking as taxpayers, in good faith, attempt to address this issue, albeit on an individualized basis.

MILLER
CHEVALIER

Thank you in advance for your consideration of this request.

Respectfully submitted,

Donald T. Rocen /MLG

Donald T. Rocen

Marc J. Gerson

cc: Joshua Odintz
John Parcell
Frank Falvo
Curt Wilson
Frank Boland
Stephanie Bland
Taylor Cortright

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

JUN 2 2010

From: Tom Wesenberg [Tom.Wesenberg@mppginc.com]
Sent: Wednesday, June 02, 2010 1:43 PM
To: Notice Comments
Subject: Notice 2010-43 priority guidance recommendation

Recommendation for 2010-2011 Guidance Priority List: Scrip and similar programs operated by organizations exempt under IRC 501(c)

The use of scrip programs as fundraisers for schools and other tax exempt organizations has become widespread. Some, though not all, include a feature whereby the purchaser of scrip receives a percentage as a tuition reduction or similar benefit (as opposed to a general benefit to the school). A similar type of program utilizes grocery store cards, wherein interested parties buy groceries with certain cards or accounts, designating a particular 501(c)(3) organization to be benefited by a percentage rebate. Often a portion of these benefits is credited by the charity to the tuition account or other type of account of the individual grocery shopper.

Currently there appears to be little clear guidance regarding the implications of these programs. Clarification and education is needed as to the following issues, at minimum:

1. Private benefit;
2. Unrelated business income taxation.

PLR-118535-09 addressed certain other matters related to scrip (under IRC sections 61 and 170). While its conclusions may suggest some direction regarding the issues listed above, the PLR specifically disclaims any guidance thereon. Accordingly, and with the limitations of PLRs generally, charities are in a position of having little if any authoritative guidance regarding matters crucial to their operations and tax exempt status. Individual participants would also benefit by having more authoritative guidance on these as well as the matters addressed in the PLR.

Given how widespread these programs have become (and in the current economic climate they almost certainly will grow), I request the Department of Treasury and Internal Revenue Service to address these issues within its 2010-2011 Guidance Priority List. (In addition, if organizations have unwittingly jeopardized their exempt status or have generated UBIT and are delinquent, some sort of amnesty program should be provided.)

Thomas D. Wesenberg, CPA
Mosley, Pfundt, Platz & Glick, Inc.
6455 Wheatstone Court
Maumee, OH 43537
419-861-1120

Notice 2010-43

LEGAL PROCESSING DIVISION
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JUN 1 1 2010

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June 10, 2010

Internal Revenue Service
ATTN: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: 2010-2011 Guidance Priority List

Ladies and Gentlemen:

The National Association of Bond Lawyers ("NABL") respectfully suggests the following items for inclusion in the 2010-2011 Guidance Priority List. Section references are to the Internal Revenue Code of 1986, and sections amended by the *American Recovery and Reinvestment Act* ("ARRA"), Pub. L. No. 111-05, are also indicated.

These items are not listed in an internal priority order. Also, by suggesting these priority items, we do not mean to withdraw any of the other items we suggested for the 2009–2010 list.

1. Guidance on the definition of "issue price" under Section 148, particularly focusing on "bona fide public offering," including for purposes of the Build American Bond (BAB) and specified tax credit bond requirements.

2. Finalize solid waste regulations under Section 142.

3. Finalize public approval requirement ("TEFRA hearing") regulations under Section 147(f).

4. Finalize allocation and accounting regulations under Section 141.

5. Guidance on other issues relating to BABs, including treatment of draw-down bonds where draws occur after 2010.

6. Guidance on record retention, including safe harbors as suggested by the Advisory Committee on Tax Exempt and Government Entities (ACT).

National Association
of Bond Lawyers

7. Update Revenue Procedure 97-13 on management contracts under Section 141(b).

8. Guidance on treatment of 501(c)(3) organizations for purposes of the $30,000,000 "bank eligible" limit under Section 265(b)(3), as well as treatment of drawdown bonds under this provision and the provisions set forth under Section 291(a)(3).

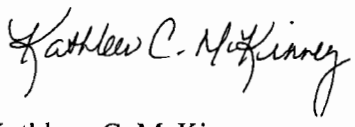
9. Amend the definition of "state or local bond opinion" in § 10.35(b)(9) of Circular 230 to cover opinions relating to BABs under section 54AA, Recovery Zone Economic Development Bonds under section 1400U-2, and tax credit bonds under section 54A.

10. Guidance on refundings of bonds issued under special ARRA provisions expiring at the end of 2010.

11. General guidance as to Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds under sections 1400U-2 and 1400U-3.

These suggestions were developed by the NABL Tax Committee, chaired by Perry E. Israel of the Law Office of Perry Israel, and have been approved by the Executive Committee of the Board of NABL. If you have any question concerning them, please contact me at kcmckinney@hsblawfirm.com, (864) 240-3243 or Perry Israel at Perry@103law.com or (916) 485-6645.

Sincerely,



Kathleen C. McKinney

cc: Clifford J. Gannett
John J. Cross III
Steven A. Chamberlin
James A. Polfer

Notice 2010-43

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JUN 10 2010

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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

June 10, 2010

VIA E-MAIL [Notice.Comments@irscounsel.treas.gov]

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
1111 Constitution Avenue, N.W.
Washington, D.C. 20024

Re: Notice 2010-43: 2010-2011 Guidance Priority List Recommendations

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity, pursuant to Notice 2010-43, 2010-22 I.R.B. 716, to offer our suggestions regarding regulatory guidance to be placed on the 2010-11 Guidance Priority List. NAREIT is the representative voice for U.S. real estate investment trusts (REITs) and publicly traded real estate companies worldwide. Members are REITs and other businesses that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service these businesses.

We request that the Department of the Treasury and the Internal Revenue Service include in their 2010-11 Guidance Priority List the following five issues, listed in order of priority, with the first two items having the greatest priority:

1) clarifying certain regulatory provisions regarding the consequences to REITs to certain "distressed" debt, as discussed more fully in a letter dated August 12, 2009 from NAREIT to then-Deputy Assistant Treasury Secretary Mundaca and Commissioner Shulman;

2) allowing a safe harbor under which non-substantial mistakes and inadvertent errors in computing and making distributions, including potential rounding errors, are disregarded so that those distributions from a REIT are not considered as preferential dividends, consistent with an item on the 2007-2008 and 2008-2009 Priority Guidance Plans "addressing the correction of minor errors by RICs [regulated investment companies] and REITs;"

1875 I Street, NW, Suite 600, Washington, D.C. 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

3) clarifying that a REIT's investment in the shares of a money market fund constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A), [1] consistent with an item in the 2009-10 Priority Guidance Plan and in accordance with the recommendations in an April 22, 2009 letter from the American Bar Association Section of Taxation (ABA Tax Section);

4) revising the regulations under section 337(d) concerning "built in gains" so that these regulations do not apply to exchanges of property from a C corporation to a REIT under section 1031 nor to transfers of property to a REIT from a corporation exempt from tax under section 501(a), consistent with an item in the 2008-09 and 2009-10 Priority Guidance Plans, and in accordance with recommendations in a May 1, 2008 submission by the ABA Tax Section; and,

5) interpreting and clarifying provisions of the REIT Investment Diversification and Empowerment Act of 2007 (RIDEA), which was included in the Housing and Economic Recovery Act of 2008 (2008 Act), consistent with an item included in the 2008-09 Priority Guidance Plan.

The reasons for the priority given to the above issues are as follows. First, because of the difficult economic climate, guidance regarding the consequences of distressed debt would help ensure that REITs can work out existing mortgage loans and participate in the market for distressed mortgage loans without jeopardizing their qualification as REITs for federal income tax purposes. Second, the issue regarding inadvertent errors in computing required REIT distributions had been on the Priority Guidance Plan for a number of years and continues to be important to the REIT industry, particularly during the current economic crisis. The other three issues would permit REITs to carry on their business with more certainty and consistent with Congressional intent.

DISCUSSION

I. Distressed Debt

As discussed more fully in the August 12, 2009 NAREIT letter, NAREIT requests guidance that would specifically provide that:

1. the "loan value" of the real property under Treas. Reg. Section 1.856-5(c) securing a mortgage loan held by a REIT is not re-tested upon a deemed exchange under Treas. Reg. Section 1.1001-3, so long as the "significant modification" occurs at a time when the mortgage loan is in default or default is reasonably foreseeable; and,

2. the "amount of the loan" under Treas. Reg. Section 1.856-5(c) for a mortgage loan acquired by a REIT with market discount is the REIT's highest adjusted tax basis during the year.

[1] For purposes of this letter, "section" refers to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

NAREIT has requested this guidance in order to clarify the treatment of distressed loans and to eliminate uncertainties that are particularly problematic for publicly traded REITs. Given the country's current economic crisis, issuance of this guidance would be particularly timely.

II. Preferential Dividends

There are situations in which a REIT inadvertently, through a "foot fault" such as a rounding error or similar situation, arguably could be viewed as having distributed a non-deductible, preferential dividend. Because these errors truly have no substantive meaning, we again respectfully recommend that the IRS issue guidance providing safe harbors as to these types of situations that will not be treated as preferential dividends, consistent with an item on the 2007-08 and 2008-09 Priority Guidance Plans addressing the "correction of minor errors by RICs and REITs."

Over the past few years, NAREIT and the trade association for mutual funds, the Investment Company Institute, have had a continuing dialogue with personnel from the Treasury Department, the IRS' Financial Institutions & Products group, and the IRS' Large and Mid-Size Businesses division regarding a mutually acceptable resolution to this difficult issue. To that end, in March 2007, we submitted a draft revenue procedure to the IRS. We are re-attaching that draft revenue procedure for your information. This issue remains of paramount importance, and we are hopeful that the IRS and Treasury Department will once again place it on the Guidance Priority List for 2010-2011 and issue guidance in this area in the next year.

III. Money Market Funds as "Cash Items" Under Section 856(c)(4)(A)

Section 856(c)(4)(A) requires that at the close of each calendar quarter of the taxable year at least 75% of the value of a REIT's "total assets" consist of real estate assets; government securities; and cash and cash items (the 75% asset test). On April 22, 2009, the ABA Tax Section submitted comments to the Internal Revenue Service requesting that the Treasury Department and the Service promptly issue guidance clarifying that a REIT's investment in the shares of a money market mutual fund (money market fund) constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A).

As the ABA Tax Section noted:

> [Money market funds] play a pivotal role in the day-to-day operations of many companies, including [REITs], when cash must be readily available to meet the needs of their business. Money market funds are an attractive alternative to interest-bearing checking accounts due to the convenience they provide, their competitive returns, and their regulatory safeguards that are intended to provide liquidity and minimal risk to principal. In light of these features common to money market funds, industry practice for financial personnel and the accounting rules such personnel rely upon generally treat money market funds as "cash items."

NAREIT agrees with the ABA Tax Section's recommendation, especially since the Administration last year took extraordinary steps to assure the stability of money market funds. An item relating to this issue was included in the 2009-10 Priority Guidance Plan.

IV. Revising Final Regulations Under § 337(d) Relating to Conversion Transactions Involving Tax-Exempt Entities

NAREIT reiterates its request for a revision to the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or regulated investment companies (RICs), in accordance with the May 1, 2008 submission by the ABA Tax Section. An item concerning these issues is contained in the 2008-09 and 2009-10 Guidance Priority Lists.

The regulations under § 337(d) implement Congress' directive as part of the repeal of the *General Utilities* doctrine in the Tax Reform Act of 1986 (the 1986 Act) to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments effected by the 1986 Act, including:

> ...regulations to ensure that such purposes may not be circumvented through the use of ... a regulated investment company, real estate investment trust, or tax exempt entity...

Section 337(d).

Prior to its repeal, the *General Utilities* doctrine allowed certain transfers of appreciated property to avoid corporate level tax. The 1986 Act eliminated those rules, effectively preventing the avoidance of corporate-level tax on the disposition of appreciated property.

We support the suggestions made in those comments, and respectfully request that the IRS and Treasury Department revise the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or RICs, in accordance with those comments.

The ABA Tax Section comments address two specific issues:

First, the ABA Tax Section points out that the § 337(d) regulations technically apply to transfers from a C corporation to a REIT or RIC in an "exchanged basis" transaction and indicates that this treatment is inappropriate. "Exchanged basis" transactions include § 1031 like-kind exchange transactions. C corporations often transfer real property in like-kind exchange transactions when a REIT is the acquirer. These transactions are commonplace, non-abusive, and do not implicate any of the concerns that are properly addressed by the regulations.

Second, the ABA Tax Section states that the § 337(d) regulations improperly treat tax-exempt corporations as "C corporations" for purposes of the regulations. It follows from this treatment that a transfer of assets from a tax-exempt corporation to a REIT or RIC can result in the

imposition of a C corporation level tax with respect to the property (under § 1374 principles if the property is sold by the REIT or RIC within ten years). As the ABA Tax Section points out, this treatment also applies in connection with a transfer of assets from a real estate partnership to a REIT when the partnership has partners that are tax-exempt corporations. Such transfers are undertaken all the time, and for the reasons given by the ABA Tax Section, NAREIT believes that the regulations should not be applied in these situations.

V. Post-RIDEA Guidance

As noted above, the 2008 Act contains several provisions the genesis of which was H.R. 1147 and S. 2002, RIDEA. NAREIT thanks the Treasury Department and IRS for the issuance of guidance thus far in response to both NAREIT's letter of August 13, 2008 requesting certain guidance under 2008 Act and an item contained in the 2008-09 Priority Guidance Plan concerning guidance for REITs under the 2008 Act. NAREIT reiterates its request for guidance relating to the following issues as further described in the August 13, 2008, letter and the follow up letter of Feb. 23, 2009:

1) confirming that dividend-like income such as Subpart F income either qualifies as "good income" under the REIT gross income tests or is excluded from the computation of such tests;

2) delineating how the modified REIT hedging rule in amended section 856(c)(5)(G)(ii) can apply to foreign currency risk management transactions that are not covered by the definition of a "hedging transaction" under section 1221(b)(2)(A), and

3) clarifying that section 856(c)(5)(G)(i) applies to hedging transactions to which the curative provisions of Treas. Reg. § 1.1221-2(g)(2)(ii) (failure to identify a hedging transaction due to inadvertent error) apply.

Furthermore, NAREIT requests that the Treasury Department and IRS issue guidance regarding the treatment of foreign currency gains for qualified business units (QBUs) of a REIT that: a) use a functional currency other than the U.S. dollar; b) but may not meet the quarterly REIT asset tests or the 75% REIT gross income test for a taxable year; and, c) otherwise could apply the principles of the proposed regulations under § 987 issued September 7, 2006 to determine whether that § 987 gain is derived from income that is described in § 856(c)(2) or § 856(c)(3), pursuant to Notice 2007-42, 2007-21 I.R.B. 1288.

Such guidance would be consistent with the legislative history to the 2008 Act, in which the Joint Committee on Taxation noted that that the 2008 Act's approach of excluding "qualified" foreign currency gains from the REIT gross income tests "supersede[s] Notice 2007-42 in the case of remittances from a QBU that uses a functional currency other than the dollar."[2] So long as the QBU meets the quarterly assets tests and the 75% income test for a taxable year, the new provisions exclude from the REIT income tests §987 gain on a remittance from the QBU to the

[2] Joint Committee on Taxation, *Technical Explanation of Division C of H.R. 3221, the "Housing Assistance Tax Act of 2008,"* (JCX-63-08), July 23, 2008, at 44.

REIT, and no tracing-type rules with respect to such §987 gain are imposed, as would have been the case under Notice 2007-42. The Joint Tax Committee then noted that "[i]t is expected that the Treasury Department will use its regulatory authority[3] to provide appropriate rules with respect to the treatment of §987 currency gain for purposes of the REIT gross income tests if a QBU does not meet the requirements of the provision."[4]

****

All of the suggested projects above would fulfill the goals and objectives set forth in Notice 2010-43. First, resolution of these issues would resolve significant issues relevant to the more than 1,000 entities that have elected REIT status and the tens of thousands of taxpayers who invest in REITs.

Second, these projects would promote sound tax administration. Specifically, in the context of how to manage distressed debt, the requested guidance could relieve uncertainties that are potentially paralyzing and avoid the need of REITs to foreclose on a loan because of this tax uncertainty. Furthermore, the preferential dividend project would allow REITs and their taxpayers certainty that minor differences in dividend payments will not result in disproportionate penalties, while simultaneously relieving the Government with having to devote unwarranted resources in negotiating closing agreements to resolve these types of issues.

Third, these projects could clearly be drafted in a manner that would enable taxpayers to easily understand and apply the guidance. We have been working with, and would be pleased to continue to work with, with the IRS in discussing both how the distressed debt guidance and how the preferential dividend guidance could be drafted so as to apply to the most common types of non-consequential "foot faults."

Fourth, we believe that guidance under these projects easily could be administered on a uniform basis. Published guidance on what constitutes preferential dividends is far superior to having to negotiate closing agreements on a case-by-case basis.

Finally, guidance on the requested projects would reduce controversy and lessen the burden on taxpayers or the Service for the reasons stated above.

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[3] Section 989(c) grants the IRS authority to issue regulations under the foreign currency provisions of §§985-989.
[4] Joint Committee on Taxation, *Technical Explanation of Division C of H.R. 3221, the "Housing Assistance Tax Act of 2008,"* (JCX-63-08), July 23, 2008, at 45.

Feel free to contact me or Dara Bernstein, NAREIT's Senior Tax Counsel, if you would like to discuss this issues in greater detail.

Respectfully submitted,

Tony M. Edwards
Executive Vice President & General Counsel

cc: Michael Mundaca, Esq.
Douglas Shulman, Esq.
Jeffrey Van Hove, Esq.
Michael S. Novey, Esq.
Clarissa C. Potter, Esq.
Stephen R. Larson, Esq.

Enclosure

Rev. Proc. 2007-____

1. Purpose

This revenue procedure sets forth a safe harbor under which dividends from a real estate investment trust ("REIT") will not be construed as preferential dividends under § 562(c) of the Internal Revenue Code and will be deemed dividends for purposes of computing the dividends paid deduction.

2. Background

.01. Under § 857(a)(1), the REIT's deduction for dividends paid generally must equal or exceed: (A) the sum of (i) 90 percent of the REIT taxable income for the taxable year (determined without regard to the deduction for dividends paid (as defined in § 561) and by excluding net capital gain); and (ii) 90 percent of the excess of the net income from foreclosure property over the tax imposed on such income; minus (B) any excess noncash income.

.02. A distribution by a REIT is not considered as a "dividend" for purposes of computing the dividends paid deduction if it is treated as a "preferential dividend" under § 562(c). The failure of a REIT distribution to be considered as a "dividend" for purposes of computing the dividends paid deduction could cause the REIT to lose its status as such.

.03. Under § 562(c), a REIT dividend distribution is treated as a preferential distribution unless:

(1) the distribution is pro rata,

(2) the distribution is made with no preference to any share of stock as compared with other shares of the same class, and

(3) the distribution is made with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

.04. The legislative history of the preferential dividend rule indicates that such rule was meant to prevent income shifting among shareholders of a personal holding company (as defined in § 542), which, by definition under § 542(a)(2), is closely held. *See* H.R. Rep. No. 1860, 75th Cong., 3d Sess. 23 (1938) ("No dividends-paid credit should be allowed in the case of a distribution not in conformity with the rights of shareholders generally inherent in their stockholdings, whether the preferential distribution reflects an act of injustice to shareholders or a device acquiesced in by shareholders, rigged with a view to tax avoidance. . . .The committee believes that no distribution which treats shareholders with substantial impartiality and in a manner consistent with their rights under their stock-holding interests, should be regarded as preferential by reason of minor difference in valuations of property distributed.") In contrast, a REIT, by definition under §§ 856(a)(6) and (h), cannot be closely held.

.05. Under § 1.562-2(a) of the Income Tax Regulations, specific illustrations of preferential dividends are set forth as follows:

(1) A corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class.

(2) A corporation will not be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock.

.06. As a general matter, § 1.562-2(a) of the Income Tax Regulations provides that a preference exists if any rights to preference inherent in any class of stock are violated. The three Examples set forth in § 1.562-2(b) of the Income Tax Regulations reflect the focus of the preferential dividend concept on discrepancies in the treatment of different holders of the same class or financially advantaging holders of one class of stock to the detriment of holders of another class of stock. Thus, de minimis and inadvertent errors should not constitute preferential dividends. *See* Hanco Distributing, Inc. v. Commissioner, 32 AFTR 2d 73-5485 (D. Utah 1973).

.07. When a preferential dividend is found to exist, the entire amount of the REIT's dividend distribution that includes the preferential dividend is not entitled to the dividends paid deduction.

3. Scope

This revenue procedure applies to the situations listed below that are recognized as not constituting tax avoidance or other circumstances that the Congress intended to be considered as preferential dividends.

The following examples are illustrative of situations that the Service will not treat as involving preferential dividends as to REITs. The Service will supplement this list as it becomes aware of similar circumstances through private ruling letter requests, fact patterns that are the subject of closing agreements and other sources of information. The Service recognizes that the examples provided in this revenue procedure are not exhaustive. No inference is intended that REIT dividends that are not specifically described in this revenue procedure constitute preferential dividends.

.01. The REIT's charter requires that dividends on preferred stock be declared or declared and paid before any dividends are paid on common stock. However, the board of directors of the REIT declares and pays dividends on the preferred and common stock simultaneously. Alternatively, the REIT's charter provides that dividends with respect to a certain class of shares be paid on a specific date, and either: a) the dividend checks with respect to that class of shares are not all mailed on the correct day, but within several days of one another; or, b) the dividend checks with respect to that class of shares are not all mailed on the correct day, but as soon as the REIT realizes the error, the relevant dividend checks are mailed

(1) In this both situations, no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, the full amount of dividends distributable on the preferred shares, as well as on the common shares, has been distributed, although not in accord with the charter provisions.

(2) In both situations, the only question is timing, and the value of any timing differential is considered to be de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to this dividend.

.02. The REIT's charter provides that dividends on all classes of preferred stock shall be paid semi-annually and before any dividends are paid on the common stock. However, the board of directors adopts a practice of making distributions to the holders of all classes of preferred stock annually and to the holders of all common stock on a monthly basis.

(1) In this situation, no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, the full amount of dividends distributable on the preferred shares, as well as on the common shares, has been distributed, although not in strict accord with the charter provisions.

(2) In this situation, the only question is timing, and the value of any timing differential is considered to be de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to this dividend.

.03. The records of the REIT contain errors regarding share transfers or the identity of its shareholders, either because of internal record-keeping discrepancies or because the shareholders (or their agents or representatives) failed to furnish correct or updated information to the REIT on a timely basis. The REIT thus erroneously pays dividends to some persons who are not shareholders and fails to pay dividends to some other persons who are shareholders. As and when such errors are discovered, they are rectified to the extent practicable.

(1) In this situation, but for such errors no share of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class. Moreover, but for such errors no class of stock has received more or less than the amount to which it is entitled as compared with any other share in any other class of stock. Furthermore, but for such errors the full amount of dividends distributable on the shares has been distributed.

(2) In this situation, such errors are, as and when discovered, rectified to the extent practicable.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends or with respect to any payment made to rectify the errors.

.04. The records of the REIT contain errors regarding the number of shares of one or more classes of stock that are outstanding because of internal record-keeping discrepancies. For example, this situation could occur if REIT employees vest in restricted stock on a certain date, but the REIT's transfer agent is unable to update its records in time to make the correct dividend payment. The REIT thus erroneously fails to pay dividends to some persons who are shareholders. As and when such errors are discovered, they are rectified to the extent practicable.

(1) In this situation, but for such errors no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, but for such errors the full amount of dividends distributable on the shares has been distributed.

(2) In this situation, such errors are, as and when discovered, rectified to the extent practicable.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends or with respect to any payments made to rectify the errors.

.05. The REIT has made all distributions with respect to its classes of stock in accordance with the terms governing the same. When the distributions are made with respect to the shares of stock, rather than any dividend ending up with one or more shareholders receiving a fraction of a cent, there was rounding either up or down to a whole cent.

(1) In this situation, some holders of stock may receive a dividend differential, due to such rounding.

(2) The rounding of a dividend to a whole cent is de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends.

.06 The REIT's charter provides for classes A, B, and C of preferred stock, as well as for common stock. Dividends on the preferred stock are to be paid before dividends are paid on the common stock. The REIT erroneously fails to pay any dividends on class C preferred stock, although it pays dividends on the other classes of preferred and on the common. The total amount of dividends paid by the REIT is 95% or more of the amount which would have been paid had the REIT paid dividends on the common and on all classes of preferred. As soon as the error is discovered, the REIT pays the amounts that it should have paid on the class C preferred stock, plus an amount in the nature of interest to compensate the Class C preferred stockholders for the delay in paying their dividend.

(1) In this situation, the amount of the errors was de minimis, and the errors are, as and when discovered, rectified. Moreover, the additional amount in the nature of interest payable as compensation for delay in payment of the dividend is intended to treat all stockholders with substantial impartiality.

(2) Thus, there is no preferential dividend paid by the REIT with respect to the dividends which were paid on the class A and class B preferred stock and the common or with respect to the payments made to rectify the error with respect to the class C preferred stock.

.07. The REIT acquires shares of its stock by purchasing them on the established securities exchange on which its stock is listed. Depending on the circumstances of the sellers of these shares, the purchases by the REIT will be treated either as dividends under § 301 or as distributions in redemption under § 302. In both cases, under § 562(b) a portion of the amounts paid by the REIT for the shares would constitute dividends for purposes of computing the dividends paid deduction.

(1) In this situation, only the shareholders who sold their shares to the REIT will be considered to have received dividends from the REIT.

(2) All purchases by the REIT were made on the exchange on which the stock is listed at the market price at the moment acquired.

(3) All shareholders of the REIT had an equal opportunity to sell their shares to the REIT at fair market value. Accordingly, all shareholders were treated with substantial impartiality.

(4) Thus, none of such purchases is considered to result in any preferential dividend.

.08. A REIT, the shares or beneficial interests of which are regularly traded on an established securities exchange ("Exchange"), creates a dividend reinvestment plan (DRIP) for its shareholders and a "cash option purchase plan" (COPP) for both shareholders and non-shareholders (together, the DRIP and the COPP constitute the "Plan"). Under the DRIP, which is available to all existing REIT shareholders of record, shareholders can elect to have the cash dividends that would otherwise be distributed to them automatically reinvested in shares of REIT common stock newly issued by the REIT. Both existing REIT shareholders of record and non-shareholders may participate in the COPP. The purchase date for shares acquired through the DRIP is the date the dividends are paid by REIT and the purchase date for the shares acquired through the COPP is the last business day of the month ("Purchase Date").

REIT regularly pays dividends quarterly. The purchase price of shares of REIT stock acquired under the Plan is determined by an objective multi-day pricing formula that applies equally to participants in both the DRIP and COPP. Under the formula, the purchase price is calculated by multiplying the average daily high and low trading prices (the "Average Price") of REIT's stock reported by the Exchange for a period from I to J business days preceding the applicable Purchase Date ("Pricing Period") less a discount of up to 5 percent that REIT's board of directors has determined to be reasonable. REIT's board of directors can adjust the discount applied to the Average Price in its sole discretion, provided that it cannot alter the discount for a particular Pricing Period after that period has begun. If a day's average high and low trading price of REIT's shares falls below a threshold price on any day of the Pricing Period, that day is ignored for purposes of the multi-day pricing formula. The multi-day pricing period is intended

to minimize unwanted volatility in the purchase price of REIT's shares that might otherwise arise if a fixed-date pricing mechanism were used. Because the pricing formula is based primarily upon an average price that is determined over the multi-day Pricing Period, it is possible that on any given Purchase Date the purchase price of common shares under the Plan may be less than the average high and low trading prices of REIT's shares on such date by more than 5 percent. Conversely, on any given Purchase Date the purchase price of common shares under the Plan may exceed the average high and low trading prices of REIT's shares on such date.

DRIP participants do not have to participate in the COPP, and COPP participants do not have to participate in the DRIP. Participants in either or both portions of the Plan may terminate their participation at any time. Participants are aware of the fixed percentage discount determined by REIT before they agree to participate in the Plan. REIT pays all administrative costs of the Plan, including printing and distributing the Plan prospectus and reports, legal fees incurred in connection with the Plan's preparation, registration fees and transfer agency fees. Administrative costs do not include brokerage fees on common stock purchases because all purchases under the Plan are made directly from REIT. The Plan is designed to enable REIT to raise capital in a cost-efficient manner on a regular, recurrent basis directly from participants in the Plan. By issuing shares through the Plan, REIT is able to avoid investment banking, brokerage, distribution and other costs typically associated with a traditional underwritten equity offering. The Plan also diversifies REIT's shareholder base by enabling retail investors to invest directly alongside REIT's large, institutional investors on a cost-efficient basis. Further, REIT believes that raising capital through the Plan is advantageous as compared to a traditional underwritten equity offering because traditional underwritten equity offerings may be perceived by the market as an indication of REIT's belief that its shares are overvalued, whereas DRIPs and COPPs, because of their continuing, regular nature, minimize any such inference.

(1) In this situation, REIT is treating its shareholders with substantial impartiality, particularly in light of the fact that REIT is willing to sell its shares using the same formula price to non-shareholders under the COPP. In addition, because the pricing formula used to determine the purchase price of shares of REIT stock acquired through the Plan relies on a multi-day average, it is not possible to determine with certainty whether the purchase price will in fact be less than, equal to or greater than the price of the shares on the Exchange on the Purchase Date. If the pricing formula produces a discount of greater than 5 percent of the trading price of REIT's shares on the Purchase Date, such discount will result from market conditions beyond the control of REIT and the Plan participants, and will not be bargained for or intended by such parties. Any discount to participants in the Plan will not be treated as a preferential dividend, but will be a cost REIT would have incurred in issuing its stock under the Plan, and is intended to result in relatively minor differences in the amounts received by shareholders of the same class of REIT shares. The Plan treats all shareholders with impartiality by giving all shareholders an equal opportunity to participate, and any discount provided by the Plan is intended to result in relatively minor differences in the amounts received by shareholders of the same class of REIT shares.

(2) REIT's payment of the administrative costs of the Plan will not constitute a distribution of property to which section 301 applies. The amount of any discount shall not be considered an administrative cost or result in any preferential dividend.

4. Procedure

Dividend distributions made by a REIT that satisfy the safe harbor of Section 3 of this revenue procedure will not be treated as a preferential dividend for purposes of § 562(c).

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 12 2010

Johnson Regina

From: Promo Concepts [promoconcepts@cox.net]
Sent: Tuesday, May 11, 2010 6:11 PM
To: Notice Comments
Subject: Notice 2010-43 Recommendations for 2010-2011 Guidance Priority List
Importance: High

Hello,

I was glad to receive the email about submitting recommendations, and I have a request that should be placed at the top of your priority:

According to the US Censes Bureau, there are over 1,000,000 immigrants from Canada, living in the United States, and are legal residents with employment in the USA. I know from speaking with my Canadian colleagues down here that the majority of us have investments and income from Canada, and when it comes time to filing taxes in the US, we receive tax statements from the Canada such as T4 (Canadian Statement of Income) & T3 (Statement of Trust/Investment Income) but it has always been a very difficult task at mapping the T4 & T3 fields to the US 1040. If you would only give us a simple explanation at what to do with each field, it would definitely help the majority of us, and I will definitely pass this on to my Canadian association, I know many of my colleague have this problem. I understand there is a tax treaty between Canada & the USA, where we are not double taxed on income, but it would also be my recommendation to get a general understanding of this treaty without having to understand a complex document, maybe the IRS could have a customer service person that is dedicated to this information and understands the Canada-US treaty tax laws?

I have called the IRS customer service number and they are at a loss on knowing what to do, they all request that I submit the question to the online help, which I have done numerous times but they don't fully understand my request. Even US accountants that are versed on Canadian tax laws do not full understand how to map the T3 & T4 forms correctly.

Thanks,
Phil

Notice 2010-43

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JUN 1 2010

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

May 18, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Subject: Recommendations for 2010-2011 Guidance Priority List

Dear Sir or Madam:

I respectfully request the issuance of published guidance under section 468B regarding the tax treatment of a single-claimant qualified settlement fund as a project to be placed on the "2010-2011 Guidance Priority List." This issue first appeared on the "Office of Tax Policy and Internal Revenue Service 2004-2005 Priority Guidance Plan." (See Attachment 1 hereto, Tax Accounting, No. 14, p. 13)

The following dialog between Donna Crisalli, Special Counsel, Income Tax and Accounting, IRS, and the undersigned is excerpted from the unofficial transcript (Attachment 2, pp. 15-16) of the February 23, 2010, IRS hearing on proposed regulations (REG-127270-06) on damages received on account of personal physical injuries or physical sickness. The focus of the hearing was on insurance companies' practices in negotiating settlements with plaintiffs:

> MS. CRISALLI: Let me ask you the question I asked the last speaker, although I'll rephrase it. How do you think we could include a rule like this in a final reg under the APA without having proposed it first, a rule such as you suggest in your written comments?
>
> MR. RISK: I'm not sure, I mean I don't understand the workings of the process as well as you do, but I assume that there's an opportunity for you to restate your proposal.
>
> MS. CRISALLI: Well, we could repropose, yes, and then that would delay the effectiveness of the other rules that we have in there.
>
> MR. RISK: Excuse me, but we're now 14 years into this. *[Referring to the fact that the proposed regulation revision addressed the amendments to Code section 104 brought by the Small Business Job Protection Act of 1996.]*
>
> MS. CRISALLI: Well, I understand.
>
> MR. RISK: And maybe 28 years. *[Referring to the legislative history preceding the enactment of the Periodic Payment Settlement Tax Act of 1982, which codifies that neither actual or constructive receipt nor economic benefit of the amount invested is*

C. The IRS Extends the Section 104(a)(2) Exclusion to Factoring Transactions

In 1999, the IRS formally eroded the constructive receipt doctrine as applied to structured settlements. That year, the IRS held the section 104(a)(2) tax exclusion to apply to monies received by structured settlement recipients for selling their future payments.[197]

The IRS looked back to their earliest structured settlement ruling,[198] noting that the periodic payments were excluded because "the individual had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump-sum amount."[199] However, the 1999 ruling held a factoring company's lump-sum payment to claimant to be of the same "character under §104(a)(2)"[200] as the future payments that claimant would have otherwise received, and therefore excludible.[201]

The 1999 ruling stands in stark contrast to the earlier 1979 ruling, as well as Congress's statements in 1982: "the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments."[202] The IRS's treatment of the proceeds from the factoring transaction portrays structured settlement payments as a secure and alienable asset. But if secure and alienable, it follows that a structured settlement constitutes a constructive receipt of the future stream of income.

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197. See I.R.S. Priv. Ltr. Rul. 1999-36-030 (Sept. 10, 1999); see also Andrada, supra note 36, at 483–84. See generally I.R.S. Priv. Ltr. Rul. 96-39-016 (June 17, 1996) (holding a lottery winner's ability to assign rights to future payments not to constitute constructive receipt).

198. See Rev. Rul. 79-220, 1979-2 C.B. 74.

199. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (emphasis added) (citing Rev. Rul. 79-220, 1979-2 C.B. 74).

200. Id.

201. See id. (declining to decide whether the transaction affected the structured settlement company making the future payments under section 130); see also Andrada, supra note 36, at 487 (noting substantial disagreement regarding the application of section 130 to this scenario prior to the enactment of 2001 legislation). Compare I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (citing Ennis v. Comm'r, 17 T.C. 465 (1951)) (observing that transferred assets are taxable if they are "the equivalent of cash . . . [being] commonly sold or given as a part of a purchase price) (emphasis added), and Rev. Rul. 68-606, 1968-2 C.B. 42 (cited as a limiting case), with I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (explaining that the factoring transaction had become common by 1999 and holding that the structured settlement "was not readily saleable," and thus not equivalent to cash).

202. H.R. REP. NO. 97-832, at 4 (1982) (emphasis added); S. REP. NO. 97-646, at 4 (1982) (emphasis added).

Of course, the IRS did not rule on the legality of the transaction, merely on the proceeds' taxability. The legality of the transaction, or at least the implied legality, would be legislated just a few years later.

D. Federal and State Legislatures Pass Laws Implicitly Approving Factoring

Because of the uncertainty of factoring transactions' impact on the original structured settlement selling company, the insurance industry lobbied against structured settlement purchasing.[203] In fact, NSSTA spent over $1.25 million on lobbying from 1998 through 2001.[204] On the other side,[205] the factoring industry, through its political persona of NASP[206] lobbied to oppose restrictions on settlement purchasing.[207] Naturally, the two sides criticized each other publicly.[208]

Those in Congress and at the Treasury viewed factoring as a contravention of the structured settlement tax subsidy's purpose.[209] As a

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203. Risk, Structured Settlements, supra note 19, at 883.

204. OpenSecrets.org, Annual Lobbying by National Structured Settlements Trade Association, http://www.opensecrets.org/lobby/clientsum.php?lname=Natl+Structured+Settlements+Trade+Assn&year=2009 (last visited Nov. 14, 2009); see Bracy Interview, supra note 28 (stating that the insurance industry "went to war with us, full out, no holds barred war—their purpose was to put us out of business" and indicating that the insurance industry sued factoring companies in state courts for interfering with insurance company contracts, and lobbied state legislatures to outlaw factoring transactions).

205. See generally HINDERT ET AL., supra note 90, § 16.01[3] ("a federal and state legislative contest ensued between those favoring and opposed to factoring structured settlements").

206. NASP is an acronym for the National Association of Settlement Purchasers.

207. Risk, Structured Settlements, supra note 19, at 884; Dyer Interview, supra note 53 ("Both sides spent huge sums of money in an effort to overwhelm the other side."). But see Bracy Interview, supra note 28 ("The view that [section 5891 and state structured settlement protection acts] were designed to punish the factoring industry is ridiculous. It was [the purchasing companies] who made the overwhelming effort to get them approved.").

208. Some of their criticisms will be referred to later in the Article, as they allegedly provide inside information.

209. 1999 Hearing, supra note 15, at 6 (statement of Rep. E. Clay Shaw, Jr.) ("The integrity of the entire system is being undone by factoring transactions . . . leaving [former plaintiffs] in the very predicament that structured settlements were set up to avoid."); id. (written statement of Rep. Pete Stark) (stating that factoring "completely frustrates what our Committee intended when it adopted the original legislation to encourage structured settlements"); id. at 12 (written statement of Joseph M. Mikrut, Tax Legislative Counsel, Department of Treasury) ("These factoring transactions directly undermine the policy objective underlying the structured settlement tax regime, that of protecting the long-term financial needs of injured persons. The factoring transactions also effectively contravene the statutory requirement conditioning favorable tax treatment to the various parties to the arrangement on the injured per-

legislative response to factoring, Senator Baucus recommended a penalty tax on factoring transactions except in court-approved cases in "instances of true hardship of the victim."[210] This legislation, proposed in 1998, would have set a very high standard of hardship.[211] Under the proposal, a court or administrative body would have had to find that "the extraordinary, unanticipated, and imminent needs of the structured settlement recipient or the recipient's spouse or depends render such a transfer appropriate."[212] Such language would likely have resulted in a severe decline in factoring transactions. Others recommended more lenient standards of court approval,[213] such as a best interests standard.[214] Soon after, the insurance and factoring industries agreed to a compromise,[215] proposing a law imposing a 40% excise tax on settlement purchase transactions without court approval.[216]

"Creatively attached"[217] to the Victims of Terrorism Tax Relief Act of 2001,[218] Congress passed the proposed legislation. The Act created section 5891, providing an excise tax of 40% for factoring

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son's inability to accelerate such payments."); 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus) ("I now find that all of this careful planning and long-term financial security for the victim and his or her family can be unraveled in an instant by a factoring company offering quick cash at a steep discount. . . . These structured settlement factoring transactions place the injured victim in the very predicament that the structured settlement was intended to avoid.").

210. 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus); Dyer Interview, supra note 53 (noting that NSSTA lobbied for a standard of financial hardship before 2000).

211. See Structured Settlement Protection Act, H.R. 4314, 105th Cong. (2d Sess.) § 5891(b)(2) (1998).

212. Id.

213. See Andrada, supra note 36, at 494.

214. 1999 Hearing, supra note 15, at 24 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) ("The court should be asking, 'what is in the best interest of the claimant?' ").

215. HINDERT ET AL., supra note 90, § 8A.03[1].

216. Risk, Structured Settlements, supra note 19, at 884 (citing Letter from NSSTA to Hon. Bill Archer and Hon. William V. Roth, Jr., chairmen of U.S. House Ways and Means Committee and Senate Finance Committee (Sept. 13, 2000)). While the factoring industry did not readily accept the court approval process, some thought that it would also benefit factoring companies because the legislation and court approvals would legitimize and secure each transaction. Bracy Interview, supra note 28. Interestingly, though Republicans are typically found on the side of insurance companies, this was not so with respect to section 5891. Because of the Republican ethic of economic liberalism, many Republican congressmen disliked the idea of requiring payees to seek court approval for factoring transactions. In fact, though NASP eventually agreed to the court approval process under the best interests standards, some Republicans still disapproved. Id.

217. Scales, supra note 2, at 918.

218. See Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002).

transactions not approved by a "qualified order,"[219] to be made by an applicable State Court or administrative authority finding the transaction to be in "the best interests of payee."[220] A House report described section 5891 as "[p]rotecting victims who sell structured settlements for a lump sum,"[221] though, as one commentator notes, "the legislation said remarkably little about the now much weakened and nebulous standard that required the factoring transaction."[222] More than simply enacting the excise tax for transactions not approved by courts, the Act also "retroactively immuniz[ed previous] factoring transactions from tax challenges."[223]

Though previous Congressional statements may have suggested antipathy for factoring, and though section 5891 punishes factoring transactions without court approval,[224] the legislation seems to implicitly approve of factoring under certain conditions.[225] NSSTA[226] and

219. I.R.C. § 5891(b)(1) (2006).

220. I.R.C. § 5891(b)(2)(A)(ii) (2006). See generally HINDERT ET AL., supra note 90, § 16.05[4].

221. H.R. REP. NO. 107-801, at 5 (2003).

222. Koenig, supra note 2 at 818.

223. Scales, supra note 2, at 918 (citing Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002)).

224. See I.R.C. § 5891 (2006).

225. See HINDERT ET AL., supra note 90, § 16.03[3][a][i] ("The Victims of Terrorism Tax Relief Act recognizes that unanticipated circumstances, in some cases, justify a transfer of structured settlement payment rights."); Richard Risk, Jr., Attorney Comments on Forthcoming Guidance on Use of Qualified Settlement Funds for Benefit of Single Claimant, 2008 TAX NOTES 30-19, Feb. 28, 2008 [hereinafter Risk, Attorney Comments] ("Since 2002, the payee has a right under Section 5891 to sell future payments, with advance written approval from a state court."); E-mail from Betty Gregware, Sales Executive, John Hancock Life Insurance Company to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 31, 2009, 1:48:48 EST) (on file with author) ("Federal statute 5891 does implicitly approve factoring through directing individuals to the state specific Periodic Payment Protection Act statues [sic] for the requirements regarding how to change their periodic payments, which include court approval."); E-mail from Earl Nesbitt, Executive Director, NASP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (June 19, 2009) (on file with author) [hereinafter Nesbitt E-mail, June 19, 2009] ("Congress and 46 states would not have created laws specifically governing the sale of structured settlement payment rights if they did not want the sales to happen. The fact that they legislated in the area shows that they approve."); Settlement Capital Corporation, Structured Settlements, http://www.setcap.com/edustructuredsettlements.aspx?pt=education (last visited Feb. 19, 2010) ("The passing of . . . IRC 5891 was monumental in establishing our industry's credibility. This law validated our industry and helps plaintiffs gain access to their structured settlement annuity payments. It also clarified that transfer sales are completely tax-free for both the annuitants and the annuity providers."). By passing legislation penalizing only unapproved factoring transactions, Congress's legislation tends to show some degree of approval, at least implicitly.

many others[227] firmly disagree with this view.[228] However, states have shown a desire to allow factoring transactions by passing "transfer acts"[229] giving their courts the power to approve the transactions, thus triggering the section 5891 exemption. Currently, forty-seven states have transfer laws, providing courts the ability to approve transfers under varying guidelines.[230] State courts have been handling

226. NSSTA's counsel maintains that factoring is "fundamentally incompatible with the purposes that structured settlements are intended to serve." Ulman E-mail, Feb. 16, 2009, supra note 39 (noting there might be a very few cases in which factoring would make sense). Ulman takes exception to the argument that the passage of section 5891 somehow implicitly approved of factoring; "To read that as implied approval of factoring is doing a grave disservice to those who passed the law." Id. Asked why Congress did not go further in establishing a barrier to factoring transactions, counsel responds, "Factoring companies are capable of lobbying just as much as anyone else. Section 5891 is the result of legislative compromise." Id.

227. At least one court has held that section 5891 "does not establish a statutory right for such transfers." Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, 2006 WL 3455055, at *2 (N.D. Cal. Nov. 29, 2006) (amended order) (rejecting an argument that a settlement's anti-assignment clause destroys the congressionally created right to factor). In addition, some call the implicit approval assertion "propaganda and misinformation." E-mail from John Darer, President, 4structures.com. LLC, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 26, 2009, 2:30:31 EST) (on file with author) [hereinafter Darer Interview]. Darer argues that section 5891 was legislated "to levy an excise tax to cure abuses in prior years and state exceptions to such a tax." Id. He cites to United States v. Testan, a United States Supreme Court case holding that the legislation of a jurisdictional statute did not simultaneously create a substantive right. 424 U.S. 392, 398 (1976). Thus, section 5891, legislating an excise tax, may not have simultaneously created the substantive right to factor. It should be noted that Testan was a suit against the United States. Because no right to money damages against the United States can exist without a waiver of sovereign immunity, the standard to establish the granting of a right of action may have been higher. See id. at 400–01.

228. The arguments for and against allowing factoring are elaborated upon in the next sub-section.

229. Scales, supra note 2, at 921. These are commonly called Structured Settlement Protection Acts. HINDERT ET AL., supra note 90, § 16.04[1] (providing a table of the various state statutes).

230. HINDERT ET AL., supra note 90, § 16.04[1] (not yet accounting for North Dakota's statute, N.D. CENT. CODE §§ 32-03.4-01 to -13 (Supp. 2009)); Structured Settlement Corporation, supra note 225. In 2000, the insurance and factoring industries worked together, Patrick Hindert, Structured Settlements in 2008—3, BEYOND STRUCTURED SETTLEMENTS, Jan. 31, 2009, http://s2kmblog.typepad.com/rethinking_structured_set/2008/12/structured-settlements-in-2008-3.html, to establish a Model State Structured Settlement Protection Act. The Act was later supported by the National Conference of Insurance Legislators. Id. In the states without protection acts, factoring transactions can still occur. I.R.C. § 5891(b)(2)(B) (2006) (allowing a transfer using the act from the state of the factoring company or life insurance company that issued the structured settlement annuity). Factoring companies do purchase structured settlements in those states. Bracy Interview, supra note 28. Bracy says that the NASP hired lobbyists in almost every state to encourage the legislation of structured settlement protection acts. Id. Of course, this is probably because without those acts, as a result of the newly legislated section 5891, all factoring transactions would face

factoring cases ever since.[231]

Different states have passed differing transfer acts.[232] Some, for example, require the additional finding that the transfer is "fair and reasonable,"[233] in addition to being in the best interests of the payee. Some courts,[234] and in fact some statutes,[235] refuse to approve transfers in excess of certain discount rates. In the end, however, it is well established that the core of a best interest test is judicial discretion.[236] Different judges scrutinize the applicable laws with different focuses.[237] However, this does not mean that state courts infrequently approve factoring transactions. Many in the factoring industry report application approvals of 95% or higher.[238] Moreover, even when

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the 40% excise tax. However, a Former Executive Vice President of NSSTA says that all but one of the forty-six structured settlement protection acts resulted from NSSTA work. Dyer Interview, supra note 53.

231. See generally 321 Henderson Receivables, L.P., v. Martinez, 816 N.Y.S.2d 298 (Sup. Ct. 2006); In re Settlement Capital Cor., 769 N.Y.S.2d 817 (Sup. Ct. 2003); Settlement Capital Corp. v. State Farm Mut. Auto. Ins. Co., 646 N.W.2d 550 (Minn. Ct. App. 2002).

232. Hindert & Ulman, supra note 102, at 19. At least one factoring company has repeatedly attempted "to circumvent state structured settlement protection acts and bind settlement obligors and annuity issuers to arbitrations." Allstate Settlement Corp. v. Rapid Settlements, Ltd., 559 F.3d 164, 172 (3d Cir. 2009).

233. Hindert & Ulman, supra note 102, at 22.

234. See In re Settlement Capital Cor., 769 N.Y.S.2d 817, 829 (Sup. Ct. 2003).

235. E.g., N.C. GEN. STAT. ANN. § 1-543.12(6) (West 2000).

236. Hindert & Ulman, supra note 102, at 22 (citing In re Settlement Capital Cor., 769 N.Y.S.2d 817 (Sup. Ct. 2003)); Interview with Jane Solomon, Supreme Court Justice, New York State Supreme Court, in New York, NY (Jan. 3, 2009) [hereinafter Solomon Interview] (citing broad discretion).

237. Solomon Interview, supra note 236. As counsel for the NSSTA observed, "The 'best interest' standard under state structured settlement protection acts is as stringent, or as lax as judges choose to make it." Ulman E-mail, Feb. 16, 2009, supra note 39; see also HINDERT ET AL., supra note 90, § 8A.04[3] ("In practice, the review of an application for authorization varies greatly with the disposition of the assigned judge."); Nesbitt E-mail, June 19, 2009, supra note 225 (observing, that "[a]t the end of the day, it's the judge," and that there is at least one judge in Texas who has said that he will never approve a transfer, regardless of the circumstances).

238. Milton & Dekruif, Firm Profile, http://www.lawyers.com/California/Glendale/Milton-and-DeKruif-3024685-f.html (last visited Feb. 18, 2010) (reporting a 98% approval rate in over 3,000 transfers); Bracy Interview, supra note 28 (reporting a rate above 95%); Solomon Interview, supra note 236 (reporting approving 75% of applications in 2007). The statistics may be inflated by the fact that applications are sometimes withdrawn. Ulman E-mail, Feb. 16, 2009, supra note 39. It is unclear how many potential purchases factoring companies turn down in order to maintain these high approval rates, though it is substantial. Bracy Interview, supra note 28; see Cravenho Interview, supra note 187 (noting that applications that are likely to be denied are not likely to be made). One broker in the factoring industry reports never having a settlement purchase sale application rejected. Id. (also reporting that at least one company maintains a rejection rate of less than half of one percent). Factoring companies work to push their approval rate as high as possible for two reasons. First,

one's application is denied, a structured settlement owner can typically re-apply without a waiting period, or disclosing the previous denial to the subsequent court.[239] The Pennsylvania Supreme Court has required such disclosure through its rules of civil procedure,[240] and calls have been made for at least one other state's supreme court to do so.[241] Given that the factoring industry currently purchases over $200 million of structured settlements each year, that is hardly surprising.[242]

E. Should Structured Settlement Recipients Be Allowed to Factor?

When considering whether to utilize a structured settlement, claimants will often know of their later ability to factor. In fact, some structured settlement planners always discuss the option with their clients.[243] One such planner calls it a "clear benefit"[244] to his clients, many of whom would not otherwise accept a structured settlement.[245]

An author once likened a plaintiff's decision to delay receiving much of a settlement to the Odyssey's Ulysses binding himself to the mast of his ship so as to prevent his future self from abandoning the vessel and swimming to the Siren's fatal shores.[246] The author comi-

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they typically pay for the application process. These range between $2,000 and $2,500. Bracy Interview, supra note 28; Cravenho Interview, supra note 187 (reporting transaction costs of between $3,000 and $4,000); 1999 Hearing (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting that seeking court approval for a structured settlement could "easily cost the consumer 10% or more . . . in attorney's fees and court costs"). Second, each rejection might have negative consequences. Some like to say that factoring companies have two "customers: the real customer and the judge." Bracy Interview, supra note 28. Both must approve the transfer. Id. Some in the industry predict that the best interests standard will become more strict as judges become more familiar with it. Ulman E-mail, Feb. 16, 2009, supra note 39.

239. Edward O. Burke, Structured Settlement Factoring, 44 ARIZ. ATT'Y 23, 30 (2008) (noting that at least one judge has ordered factoring companies to disclose previous applications).

240. See PA. R. CIV. P. 229.2 (f) (2007).

241. Burke, supra note 239, at 30 (discussing Arizona). The author agrees with such calls.

242. Cravenho Interview, supra note 187. In 2007, one judge reported approving 75% of all factoring transaction applications. Solomon Interview, supra note 236.

243. Meligan Interview, supra note 31. One leading commentator suggests that while some structured settlement advisors will provide advice about factoring, most do not have the knowledge to do so. Hindert E-mail, Sept. 4, 2009, supra note 45.

244. Meligan Interview, supra note 31.

245. Id.

246. Smith, supra note 56, at 1969–70 (citing JON ELSTER, ULYSSES AND THE SIRENS: STUDIES IN RATIONALITY AND IRRATIONALITY 1-111 (rev. ed. 1984)). See generally THE ODYSSEY OF HOMER 242–43 (Allen Mandelbaum trans., Bantam Classics 1990) ("I sealed the ears of my crew in turn. That done, they bound my hands and feet, as I stood upright on the mast box; and they tied the ropes hard fast around the

cally noted, "The difference between Ulysses and the plaintiff in the structured settlement is that, so far as we know, Ulysses did not get a tax break to encourage being bound."[247] Actually, as of the early 1990s, there is another key difference; Ulysses could not untie himself for a given price.

This section describes the reasons for and against allowing structured settlement recipients to factor. The strongest argument for allowing factoring is that persons should be able to respond to changed circumstances. In opposition, however, one must consider the purpose of binding one's future self, and the costs of unbinding.[248] The Article then considers whether allowing factoring renders the tax subsidy ineffective at accomplishing its purpose of discouraging premature dissipation, finding that factoring may strengthen the subsidy's effectiveness.

1. The Right to Factor

No one can predict the future. Though structured settlements encourage one to delay receiving monies so as to protect one's future interest, they also force a claimant to make decisions about how much money he or she will need, and when,[249] often long before such knowledge is available. Thus, the pre-arranged payments likely will not accurately anticipate a claimant's future needs.[250] Where a structured settlement owner, because of such unexpected needs, wishes to make use of their future payments, it would not make sense to prevent them from doing so. Of course, the definition of "unexpected" becomes the central variable in that argument. Through the 1999 legislation, Congress left that decision to the judgment of courts.[251]

One could also argue that Congress should allow factoring to counteract plaintiff attorneys' perverse incentive to inadequately re-

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mast . . . . My heart longed so to listen, and I asked my men to set me free . . . . But when we'd passed beyond the Sirens' isle . . . [t]hey freed me from my mast.").

247. Smith, supra note 56, at 1969–70 (citing ELSTER, supra note 246, at 1-111).

248. Historically, there have also been accusations that the factoring industry used "abusive tactics against the disabled." Randy Dyer, Letter to the Editor, Structured Settlements Need Watchful Eye, N.Y.L.J., Oct. 21, 1999, at 2 (Executive Vice President of National Structured Settlements Trade Association). At least some factoring companies circumvented anti-assignment clauses by directing plaintiff to send a change-of-address notice to the structured settlement company making the periodic payments, and then sign over power-of-attorney privileges to the factoring company, allowing the periodic payments to be deposited by the factoring company. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999).

249. See Luther, supra note 42, at 30.

250. Andrada, supra note 36, at 477.

251. See I.R.C. § 5891 (2006).

present their clients. One author argues that such attorneys may not spend the necessary time to accurately design a structured settlement payment schedule because they operate on a contingency fee basis.[252] So long as the present value of the settlement remains the same, a contingency fee of 30% will produce the same payment whether the payment schedule accurately predicts a clients' needs or not. Thus, the ability to escape the structured settlement plan may compensate for incentivized attorney misrepresentation.

These arguments suggest that Congress should allow factoring, at least sometimes. In addition, positive notions of alienability favor the right to factor. While it is beyond the scope of this Article, some support for claimants' alienability of their future structured settlement payments can be found in the Uniform Commercial Code Revised Article 9,[253] which "has a general purpose of promoting commerce by allowing the pledging and other assignment of payment rights in order to facilitate credit transactions."[254] Evidence for such a position can be found in several sections of the Code's 1999 Revision,[255] and factoring companies have frequently cited Article 9 in asking courts to

252. Andrada, supra note 36, at 477.

253. PAUL J. LESTI, STRUCTURED SETTLEMENTS § 19:11.1. (2d ed. 2008) ("If a state passes the revision to Article 9 of the U.C.C. in its current proposed form, it appears that factoring transactions will be allowed under that state's U.C.C. However, many states that have passed or considered this revision to their state's U.C.C. law have amended it to prevent a person from factoring their rights under structured settlement, workers' compensation and special needs trust arrangements."). Some also cite to the Restatement (Second) of Contracts. See HINDERT ET AL., supra note 90, § 16.02[2][f] (holding that a contract can be assigned unless (a) the substitution of the right would materially change the obligor's duty, burden, risk, or materially reduce the value of his contractual right, or (b) the assignment is ineffective on statutory or public policy grounds, or (c) the assignment is legitimately prohibited by contract) (citing RESTATEMENT (SECOND) OF CONTRACTS § 317(2) (1981)).

254. HINDERT ET AL., supra note 90, § 16.02[2][e] ("When Article 9 was revised in 1999, a major purpose was to expand the range of financial obligations covered by Article 9, and thus eligible for assignment despite contractual anti-assignment language.")

255. U.C.C. § 9-102, Official Comment 15 (2000) ("Note that once a claim arising in tort has been settled and reduced to a contractual obligation to pay (as in, but not limited to, a structured settlement), the right to payment becomes a payment intangible and ceases to be a claim arising in tort."); id. at § 9-406(d)(1) (holding an agreement term between account debtors and assignors ineffective, with exceptions, to the extent that it "prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note"); see LESTI, supra note 253; HINDERT ET AL., supra note 90, § 16.02[2][e]. See generally id. § 9-101 (citing § 9-102 for the definition of a "Commercial tort claim").

ignore anti-assignment language in structured settlement contracts.[256] However, there are substantive counter-arguments to the assertion that Article 9 applies to structured settlement factoring transactions.[257]

2. Factoring Discount Rates

In allowing factoring, it is important to recognize that the cost of factoring to a structured settlement recipient may render such transactions adverse to public policy goals. Again, the purpose of the tax subsidy is to encourage plaintiffs to delay receipt of their money so as to maintain funds for their later life needs. Even if a change in circumstances places the owner of a structured settlement in a difficult financial position, selling their future stream of income at a high discount rate could reduce their award or settlement value so as to guarantee that their later financial needs will not be met.[258]

Historically, discount rates have been very high, even reaching 55%, 65%, and 75%.[259] This means that a structured settlement owner due future payments with a present value of $100,000 might sell the stream of income for an immediate lump-sum of $25,000. Authors point to plaintiffs selling their future payments in desperation as the primary cause of the factoring industry's growth.[260]

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256. HINDERT ET AL., supra note 90, § 16.02[2][e] (specifically noting § 9.318(4) of Article 9 prior to the 1999 Revision, and § 9-109(d)(8) of Article 9 of the 1999 Revision).

257. U.C.C. § 9-109(d)(8) (2000) (holding Article 9 inapplicable to "a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable"); see HINDERT ET AL., supra note 90, § 16.02[2][e]; LESTI, supra note 253, § 19:11. In fact, the majority of states have specifically legislated that Article 9 is inapplicable to structured settlements. HINDERT ET AL., supra note 90, § 16.02[2][e].

258. Goldberg & Mauro, supra note 1, at 64. Of course, the high discount rate may very well result from the structured settlement recipient's lack of other options. See Halpern, Protecting Plaintiffs From the Squandered Settlement, N.C. L. WKLY., Dec. 1, 2008, at 13. Those in the factoring industry agree that claimants selling structured settlements are typically in "dire straights . . . and with no other options." Cravenho Interview, supra note 187. As few as 10% of those selling their settlements are likely not in such an ominous situation. Id. In analyzing the 1999 proposed factoring legislation, the Joint Committee on Taxation acknowledged the argument that "deep discounting of the value of the payment stream may financially disadvantage injured persons that the [subsidy] was designed, in part, to protect." JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

259. Sale of Structured Settlements Received in Tort Claims: Disclosure and Court Approval Requirements: Hearing on S.B. 491 Before the S. Judicial Comm., 1999 Leg. (Cal. 1999) (statement of Sen. Johnston); Andrada, supra note 36, at 472 (citing Mannix, supra note 27, at 66; O'Connell, supra note 27, at A8).

260. Andrada, supra note 36, at 473 (describing factoring as an option of "last resort").

Until recently, discount rates decreased substantially. Though high discount rates of 30% or more were common in the early 1990s, they dropped by half before the end of the decade,[261] averaging between 16% and 18%.[262] The decline continued until the financial crisis in 2008.[263] The average discount rate may have reached as low as 8% or 9%,[264] though some companies continued to charge rates between 15% and 20%.[265] However, after the 2008 financial crisis, average rates rose again to over 14% or 15% within the first few months of 2009, often approaching 20%.[266]

Some argue that high discount rates are a necessary evil.[267] Such authors have pointed to the need for factoring companies to borrow money at high rates,[268] increasing their total capital costs.[269] Clearly,

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261. Scales, supra note 2, at 930 (citing Interview with Earl Nesbitt, Vice President and General Counsel, Settlement Capital Co., in Halladale, Fla. (Oct. 29, 2001)). But see Sale of Structured Settlements Received in Tort Claims: Disclosure and Court Approval Requirements: Hearing on S.B. 491 Before the S. Judicial Comm., 1999 Leg. (Cal. 1999) (statement of Sen. Johnston) (reporting above 50% rates in 1999); 1999 Hearing, supra note 15, at 33 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting an average discount rate of 16% to 22%, but acknowledging discount rates of 30% in some circumstances).

262. 1999 Hearing, supra note 15, at 18 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

263. Bracy Interview, supra note 28.

264. Id. (estimating an average discount rate between 9% to 11%); Cravenho Interview, supra note 187 (estimating an average discount rate between 8% to 10%).

265. Cravenho Interview, supra note 187. Others estimate that the average discount rate in early 2008 was 13%, but climbed to 16% or higher in late 2008, primarily due to the lack of available capital. Nesbitt E-mail, June 19, 2009, supra note 225. Had the crisis not occurred, Nesbitt believes that the rate would have fallen to an average of 12%. Id.

266. Bracy Interview, supra note 28; cf. Cravenho Interview, supra note 187 (indicating rates of 10% to 12% at the beginning of 2009). As noted in the Part III.B., funding for factoring companies has become less available, and thus the price of borrowing such funds has increased. Bracy Interview, supra note 28. As a result, discount rates have increased. Id. Discount rates will also likely be higher for riskier annuities, such as AIG. Still, at least some factoring companies will purchase AIG annuities. Id. (stating that Settlement Capital Corp. will do so). There was a report in 2009, however, that discount rates were available for as low as 7.75%. John D. Darer, If You Have to Sell, Don't Get Ripped Off! Effective Discount Rates as Low as 7.75%, STRUCTURED SETTLEMENTS 4REAL, http://structuredsettlements.typepad.com/structured_settlements_4r/2009/08/if-you-have-to-sell-dont-get-ripped-off-effective-discount-rates-as-low-as-775.html (Feb. 19, 2010).

267. See Scales, supra note 2, at 930.

268. Id. at 931 (citing J.G. Wentworth Amended Registration Statement, at http://www.sec.gov/archives/edgar/data/1047706/0000950115-97-001940.txt (Dec. 11, 1997)) (citing a borrowing rate of 9%).

269. Scales, supra note 2, at 931 (noting capital costs of between 11% and 14%); see also 1999 Hearing, supra note 15, at 33 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (pointing to capital costs as high as 10%

a factoring company cannot offer discount rates below what is required for operating costs. However, although the business model may demand such high rates, its cost to structured settlement recipients could still render factoring a contravention of public policy.

Of course, factoring companies are not forcing themselves on structured settlement recipients. Former personal injury claimants voluntarily enter into such transactions. And, in fact, the factoring industry claims that 92% of claimants who sell their right to future payments are satisfied with their decision.[270] According to factoring industry statistics, these owners likely understand what they are losing. According to J.G. Wentworth, over 70% of surveyed structured settlement sellers received periodic payments for over ten years.[271] Another factoring company reported that over 85% of structured settlement sellers are gainfully employed.[272]

Still, many describe selling as a decision of "last resort."[273] The latter description likely explains why some factoring companies are reporting increased purchasing[274] even as discount rates climb.

3. Undermining and Promoting the Subsidy's Purpose

Having recounted the nature of factoring, we can consider whether allowing factoring truly undermines Congress's purpose in creating the tax subsidy. Clearly, the ability to sell one's structured settlement undermines the self-binding nature of the structured settlement. Equally clear, the significant losses incurred via high discount rates may increase the chances of former claimants requiring later government support, again undermining the tax subsidy's purpose.

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as a result of "not hav[ing] access to traditional sources of capital"). Because the safety net of state guaranty associations may very well not apply to factoring companies, access to capital is more expensive. See Settlement Quotes, A Couple Points, Oct. 30, 2008, http://www.structuredsettlement-quotes.com/blog/?p=171#more-171 (stating that the protections of guaranty associations do not apply to factoring companies).

270. 1999 Hearing, supra note 15, at 20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

271. The #1 Reason, supra note 18.

272. 1999 Hearing, supra note 15, at 35 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the National Association of Settlement Purchasers) (representing that more than 85% of those selling are employed and without long term disability).

273. Andrada, supra note 36, at 473; Bracy Interview, supra note 28.

274. Bracy Interview, supra note 28 (reporting an increase in purchasing volume of 10%). As noted elsewhere, however, decreased access to funding has severely limited the amount of purchasing that some factoring companies can afford. See supra Part III.B.

However, in two equally significant ways, factoring allows the structured settlement tax subsidy to operate and fulfill its purpose of discouraging premature settlement dissipation.

As noted, there is a strong argument for allowing structured settlement recipients to sell their future periodic payments when they encounter unpredicted financial changes. In those situations, factoring does not violate the justification.[275]

Second, for all structured settlement payees, those in financial straits and those not, factoring does not reduce the incentive to structure. It is true that nearly all applications for factoring transactions are approved.[276] But, it is also true that many plaintiffs may utilize a structured settlement only because they learn of the ability to factor.[277] And, it must be remembered that the factoring company is not entitled to the same tax subsidy exclusion of periodic payments as the claimant.[278] As a result, the company's payment to the claimant will not incorporate the value of the tax subsidy.[279] Thus, in choosing to factor, the claimant must sacrifice the monetary encouragement that Congress legislated to encourage the use of structured settlements. Though factoring allows claimants to alienate the future rights that Congress hoped they would not, the tax subsidy continues to operate, discouraging them from doing so.

In fact, the ability to factor likely supports the tax subsidy's goal by encouraging the use of structured settlements. Before factoring became common, several commentators noted that the inability to alienate one's future payments was a strong disadvantage to the structured settlement.[280] This is no longer the case. Practitioners have noted that the increased flexibility of the modern structured settlement makes their use more likely,[281] though only 5% actually end up factoring.[282] Thus, while it is true that Congress's implicit approval of factoring,

275. It could be argued that one's knowledge of the ability to factor in the case of financial challenge renders one more likely to end up in financial straits.

276. See supra note 238.

277. Meligan Interview, supra note 31. But see McCulloch E-mail, supra note 17 (referring to factoring "not [as] a right, but rather a right to ask").

278. E-mail from Matt Bracy, General Counsel of Settlement Capital Corp. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law, Apr. 15, 2009; see I.R.C. § 104(a) (2006).

279. The lost tax subsidy is reflected by the proportionately higher discount rate. While the former claimant does not pay tax on the lump-sum purchase amount received from the factoring company, it indirectly does so through the discount rate, which must reflect the income tax cost to the factoring company for receiving the future payments.

280. E.g., Yandell, supra note 50, at 73.

281. E.g., Meligan Interview, supra note 31.

282. Nesbitt E-mail, Sept. 11, 2009, supra note 183.

after court approval, substantially erodes the application of the constructive receipt doctrine to structured settlements, doing so may very well further public policy ends.[283]

F. Looking Back at Where Congress Began

Consider where the exclusions for structured settlements began. One revenue ruling allowed a structured settlement recipient to exclude the periodic payments, after noting that the recipient had no rights to the annuity itself.[284] A second revenue ruling allowed the exclusion of periodic payments because plaintiff received "neither actual nor constructive receipt, nor the economic benefit of the present value of the damages."[285] Three years later, the committee reports for the Periodic Payment Settlement Tax Act of 1982 stated, "the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments."[286]

Clearly, the 1988[287] and 2001[288] enactments relaxed the application of the constructive receipt and economic benefit doctrines to structured settlements. Plaintiffs can hold greater rights to their periodic payments than general creditors,[289] and sell those rights for their present value upon a state court's approval. As the constructive receipt and economic benefit doctrines relate to the claimant's level of control over the settlement monies, it seems logical to assert that the deconstruction of the two doctrines contravenes Congress's stated goal of preventing claimants from quickly dissipating their settlements. Simply stated, monies cannot be prematurely dissipated unless they are received, or the right to receive them in the future is alienable.

However, though a structured settlement recipient has been given greater and more flexible rights with regard to their expected future periodic payments, the strong incentive of the tax subsidy endures.

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283. It is important to remember that where court approval is a rubber-stamp, rather than the result of substantive consideration, the argument may fail to hold. See supra Part III.D.

284. Rev. Rul. 79-220, 1979-2 C.B. 74.

285. Rev. Rul. 79-313, 1979-2 C.B. 75.

286. H.R. REP. No. 97-832, at 4 (1982) (emphasis added); S. REP. No. 97-646, at 3 (1982) (emphasis added).

287. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A)-(B), 102 Stat. 3342.

288. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002).

289. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342.

Personal injury victims considering the use of a structured settlement are now encouraged by the increased security of their future payments, due to the 1988 amendment, as well as the alienability of their future payments, due to the 2001 legislation. In considering whether to sell one's payments however, the created subsidy operates to incentivize against doing so.

IV.
HELPING THE WRONG PARTY

Thus far, this Article has demonstrated the initial applicability and subsequent erosion of the constructive receipt and economic benefit doctrines as applied to structured settlements. This Part provides the context for the most recent, and quite substantial continuation of these two patterns: the use of qualified settlement funds in single-claimant cases, to be discussed in Part V. As will be shown, qualified settlement funds in single-claimant cases are sometimes used to circumvent a defendant's or liability insurer's ability to reap a substantial portion of a structured settlement's monetary benefits. This section describes the three ways that defendants and liability insurers can do so, and argues that such an ability may contravene Congress's purpose in subsidizing structured settlements.[290]

A. Capturing the Monetary Benefits of a Structured Settlement

Proponents of structured settlements often speak of a structured settlement's ability to benefit both sides, allowing plaintiff to receive more, while defendant pays less.[291] Defendants are able to capture much of the benefit resulting from the use of a structured settlement. Likely for this reason, those inside and outside the industry believe that the structured settlement was either a "defense tactic"[292] from the beginning,[293] or became one thereafter.[294] Often represented by their

290. Of course, benefits accrue to defendants and liability insurers without the subsidy. However, the subsidy increases the benefits by increasing the overall number of structured settlements.

291. See, e.g., Scales, supra note 2, at 880–81; Goldberg & Mauro, supra note 1, at 39; A Roundtable, supra note 10, at 70 (comments of Roger Warin).

292. Risk, Structured Settlements, supra note 19, at 868.

293. Id.

294. Scales, supra note 2, at 897 (Scales reports being told by a major multi-line insurer when researching the structured settlement that it has been "a defense product from the beginning"). In 1999, the factoring industry argued that insurance companies use structured settlements to reduce costs. 1999 Hearing, supra note 15, at 36 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the NASP). NASP presented evidence from an insurance company's manual; "The primary objective in expanding the use of structured settlements is to maxi-

insurers during settlement negotiations,[295] defendants have enjoyed the advantages of experience, partly as a result of being "repeat players."[296] As a consequence, some argue that "physically injured victims often are victimized a second time, unknowingly to them, when the settlement is made."[297] Over the years, estimates of defense-side savings have decreased from between 50% and 75% in 1974,[298] to between 20% and 40% in 1978,[299] and recently to between 20% and 25%.[300] The decline is likely a result of plaintiff lawyers' increased

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mize their value as a tool to reduce both claim loss and expense costs." Id. (quoting The Travelers Structured Settlement Manual). The factoring industry also cited to a telling trial transcript. In the cited trial, counsel to State Farm argued that one of the structured settlement tax exemption's purposes is to protect the plaintiff. Id. at 33 (citing Transcript of Record, Stone Street Capital v. Jackson, Civ. No. 176131). The court admonished, "No it is not. The reason for setting up these structured payments are so that the insurance companies can settle out cheaper." Id. at 34. When counsel tried to respond, the court interrupted, "That is the reason. That is the reason." Id. With these and other examples, the factoring industry argued that NSSTA's antagonism for the factoring industry was based on the industry educating the public about the true value of structured settlements. Id. at 33 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the NASP). Similar remarks were made in contemporary articles. James D. Terlizzi, Perspective, Understand Structured Settlement Refinancing Issues, N.Y. L.J., Sept. 27, 1999, at L7, L15 (General Counsel and Chief Operating Officer of Peachtree Settlement Funding of Norcross, Ga., a factoring company).

295. Goldberg & Mauro, supra note 1, at 35–36.

296. Smith, supra note 56, at 1972. Commentators complain that claimants' attorneys often allow defendants or defendants' insurers to control the structuring of the settlement. See Risk, Structured Settlements, supra note 19, at 887. However, this problem may be diminishing, as plaintiff attorneys become increasingly assertive in the structuring of their clients settlements. See id. at 901. Guides to plaintiff lawyers warn readers to guard against some of defense practices discussed above. See STEPHEN J. HERMAN, Personal Injury Settlements, in PLAINTIFF'S PERSONAL INJURY FROM START TO FINISH 94 (2006).

297. Risk, Structured Settlements, supra note 19, at 888. Risk argues that plaintiffs are legally entitled to the tax subsidy, see id. at 892, and reports, "Many plaintiff attorneys who rightly were concerned over their own exposure to a legal malpractice claim by allowing the adversary to handle this transaction on behalf of their client simply had their clients take the cash." Id. at 892.

298. Choulos, supra note 21, at 74 (citing Wallace E. Sedgwick & William C. Judge, The Use of Annuities in Settlement of Personal Injury Cases, 44 INS. COUN. J. 548 (1974)).

299. Periodic Payments Prove Aid to Accident Victims, J. COM. & COM., Mar. 20, 1978, at 8 (quoting Kenneth Wells, a consultant at Walker, Sullivan and Co. of Los Angeles).

300. Scales, supra note 2, at 882; see also Risk, Structured Settlements, supra note 19, at 870; JOINT COMM. ON TAXATION, 106TH CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999) ("[A]nother possible outcome is that the defendant could spend somewhat less . . . and purchase an annuity as part of a structured settlement arrangement that would pay the recipient . . . [less] annually for the rest of his or her life. Under this scenario, the recipient would be indifferent as between choosing the structured settlement arrangement and receiving a

familiarity with structured settlements and the use of plaintiff-side brokers.[301] Of course, these estimates are just that, estimates.[302] The author was unable to find any empirical support.

Whether or not such savings occur frequently today, defendants and liability insurers have proven themselves capable of utilizing the structured settlement to minimize[303] their damages in three ways: (A)

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lump sum payment of [more money]. . . . However, the defendant would save [a substantial amount] in expenditures to settle the case.").

301. HINDERT ET AL., supra note 90, § 1.04[4] ("During the early development of structured settlements, defendants maintained an information and resource advantage over plaintiffs, a condition that dissipated in the 1990's.") (citing Rudnitsky & Blyskal, supra note 9, at 29); NSSTA Letter, supra note 14, at 3 (asserting that both defendants and plaintiffs generally have brokers); Darer Interview, supra note 227 (noting that while some plaintiffs may agree to a structured settlement without a structured settlement expert, such cases are becoming increasingly rare, as their attorneys become educated on the increasing complexity of settlement planning issues and bring in settlement consultants as part of the team). See Bracy Interview, supra note 28 (stating that plaintiff attorneys and plaintiff-side brokers became more aware of structured settlements about ten years ago, and that both plaintiffs and defendants often have brokers); Ulman E-mail, Feb. 16, 2009, supra note 39 (noting that claimants attorneys have become more knowledgeable about structured settlements).

302. Some question whether defendants truly save money by using structured settlements at all. E-mail from Patrick J. Hindert, Managing Director, S2KM Ltd., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law. (Aug. 17, 2009, 8:33:00 EDT) (on file with author) [hereinafter Hindert E-mail, Aug. 17, 2009]. They ask two important questions. First, "Where is the independent, objective proof?" Id. And second, "Why would an informed plaintiff attorney ever knowingly accept a lower fee from his client for a structured settlement costing defendants less than an alternative cash settlement?" Id. The author could find no data to answer the first question. However, the second question can be answered. Calculating the alternative fees from a structured versus lump-sum settlement may be outside of the plaintiff attorney's abilities. Where defendants do save money, that same commentator lists the primary reasons as "1) misrepresentation, 2) failure to disclose; or 3) negotiation pressure." Id. Thus, he recommends that plaintiff attorneys be "more aggressive in discovery to elicit information from defendants about structured settlement compensation, conflicts of interest, and company policies as well as more accurate cost and present value calculations." Id. ("If you ignore profits from product sales and assume full disclosure of compensation and costs with no misrepresentations and no unauthorized practice of law (agents providing legal services to save defendants legal costs), I don't see how defendants save money using structured settlements.").

303. It may be more accurate to describe defendants as minimizing damages, or offsetting costs, rather than "saving" through these three strategies. Some disagree with the characterization of these practices as "savings." E-mail from Richard B. Risk, Jr., Attorney, Risk Law Firm, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Aug. 15, 2009, 12:16:27 EST) (on file with author) [hereinafter Risk E-mail] (using language such as "bridging the gap" or "offset[ting] the cost of settling a claim"). However, the term "saving" is used here simply to mean that defendants end in a financially superior position by using a structured settlement than by using a lump-sum. This is done by either paying less, or by recouping some of their payment by profiting elsewhere.

negotiating future payments based on nominal, rather than real value, (B) profiting through the purchase of the structured settlement annuity, and (C) negotiating to benefit from the tax subsidy.[304] Based on the research below, the author concludes that defendants and liability insurers do minimize settlement costs through structured settlements today. Because the tax subsidy encourages structured settlements, it makes the first two cost minimization methods more available.

1. Negotiating on Nominal Terms

Due to inflation, one dollar in ten years is worth far less than one dollar today. If invested prudently, one dollar today will increase in value faster than inflation. Thus, a defendant who can promise plaintiff $100,000 spread out in monthly payments over ten years is far better off doing so than paying plaintiff $100,000 in cash today. As will be shown below, defendants prefer to negotiate in terms of future nominal dollars, rather than present value. Defendants have been utilizing this strategy, called a "short-changing scheme"[305] by a court of law, for over four decades.

Many have documented defendants and their insurers not disclosing the present value or cost of the structured settlement to plaintiff in the past.[306] By withholding such information, defendants deceive[307]

304. The frequency of these strategies being successfully practiced today will be discussed. One settlement planner believes them to be practiced "rarely," "frequently," and "occasionally," respectively. E-mail from Jack L. Meligan, Plaintiff Loyal Settlement Planner, Settlement Professionals Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Aug. 20, 2009, 3:54:43 EST) (on file with author).

305. Macomber v. Travelers Prop. & Cas. Corp., 804 A.2d 180, 186 (Conn. 2002); see Lyons v. Med. Malpractice Ins. Ass'n, 730 N.Y.S.2d 345, 346, 286 A.D.2d 711, 712 (N.Y. App. Div. 2001) (reversed and remanded on the factual issue of insurer representation after finding privity between a plaintiff and defendant for purposes of the represented value of the structured settlement).

306. See Andrada, supra note 36, at 471–72; ROBERT W. WOOD, TAXATION OF DAMAGE AWARDS AND SETTLEMENT PAYMENTS § 7.24 (3d ed. 2005) [hereinafter WOOD, TAXATION OF DAMAGE AWARDS]; LESTI, supra note 253, § 1:2; Risk, Structured Settlements, supra note 19, at 888; Frolik, supra note 55, at 573–74; 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of NASP); id. at 34 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding); A Roundtable, supra note 10, at 76 (comments of Herb Cumming). But see NSSTA Letter, supra note 14, at 3 ("Industry practice is to provide the claimant and counsel with a detailed factual presentation regarding the cost of various components of the settlement, including the annuity cost and total future payout for the structured payments. Industry practice is to spell out the annuity cost as part of the settlement offer. Plaintiff's counsel has to know the cost of the structured settlement annuity in order to calculate the attorney's fee, which must be determined on the basis of the present value of the settlement."). Some in the insurance industry argue that it is not difficult for a plaintiff attorney to learn the

plaintiffs into believing that the settlement is worth more than its true value.[308] For example, one case regarded the representation by the Medical Malpractice Insurance Association to plaintiffs that a structured settlement package, including an annuity providing for payments of $3,000 per month for life to an infant, carried a present value of $940,180.[309] In fact, the package's true present value was $410,000.[310]

In the past, the insurance industry has taken steps to maintain plaintiffs' lack of present value information. It has done so both through misinformation and political action. For years, defendants and insurers maintained that plaintiffs and their attorneys could not know the present value or cost of a structured settlement without breaching constructive receipt.[311] Such receipt would prevent plaintiff from utilizing the tax benefit of section 104(a)(2). This has been held untrue.[312] Later, defendants and insurers also asserted that involve-

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present value of an offered structured settlement. See Dyer Interview, supra note 53. Though a broker providing such information may not earn a commission by advising in that transaction, he or she will often advise anyway, hoping to make commissions on the requesting attorneys' subsequent settlements. See id.

307. Some commentators find defendants' representation of structured settlements' values to constitute fraud. Risk, Structured Settlements, supra note 19, at 889. Others simply argue that a claimant's attorney should always know the cost to defendant. See A Roundtable, supra note 10, at 76 (comments of Lawrence Charfoos); id. at 76 (comments of Herb Cumming).

308. See Andrada, supra note 36, at 471–72; WOOD, TAXATION OF DAMAGE AWARDS, supra note 306, § 7.24; LESTI, supra note 253, § 1:2; Goldberg & Mauro, supra note 1, at 44; Frolik, supra note 55, at 573–74; 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of NASP); id. at 34 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the National Association of Settlement Purchasers); Terlizzi, supra note 294, at L7 (General Counsel and Chief Operating Officer of Peachtree Settlement Funding of Norcross, Ga., a factoring company); A Roundtable, supra note 10, at 76 (comments of Herb Cumming). However, Cumming noted that plaintiff attorneys had a relatively new tool available, Merrill Lynch's Total Agreement program, which enables a plaintiff attorney to "determine the value of a case and then to consider what income stream that money could provide to best meet the needs of the client, given his or her age, family situation, and so forth. . . . The present day value or cost of a settlement need not be a secret anymore." Id.; see also id. at 80 (comments of Charles Krause).

309. Lyons v. Med. Malpractice Ins. Ass'n, 730 N.Y.S.2d 345, 346 (N.Y. App. Div. 2001).

310. Id.

311. E.g., Joseph E. Murphy, Structured Settlements, THE VERDICT, Oct. 1986, at 11 ("It is of the utmost importance that in describing such an annuity, the purchase price of the annuity not be mentioned but simply the schedule of payments."); cf. Gregware Interview, supra note 17 (stating that over fifteen years ago, it was widely believed that claimant knowledge of present value would constitute constructive receipt).

312. See I.R.S. Priv. Ltr. Rul. 90-17-011 (Jan. 24, 1990) ("[T]he exclusion from gross income does not apply to punitive damages in connection with a case not result-

ment of a plaintiff broker in structured settlement negotiations constitutes constructive receipt.[313] Commentators have argued that this is false as well.[314]

The insurance industry has also worked to prevent plaintiff-side support for structured settlement negotiations from growing. One commentator argues, "Although [NSSTA's] mission statement does not overtly exclude plaintiff advocates, NSSTA was organized by those who wanted to preserve the structured settlement concept as a defense tool."[315] For example, in 1999, NSSTA worked to defeat proposed legislation in both Florida and New Hampshire that would have allowed structured settlement plaintiffs to select their broker and funding structure.[316] Members of NSSTA have acted similarly. From early on, commentators report, "annuity issuing life insurance companies . . . restricted their appointments to those brokerages (general agencies) that would prohibit their individual agents from working on behalf of injury victims and their attorneys."[317] While many of these tactics are no longer employed, others allegedly continue.

Currently, there is a class action against Hartford Financial Services Group alleging that Hartford's liability insurer subsidiaries "operate in tandem [with inside and outside brokers] to deliberately erect an information barrier to protect defense interests."[318] Plaintiffs also allege that Hartford and its in-house brokers "colluded to submit falsely inflated cost information to unwitting injury claimants (and their attorneys when retained) about the true amount of money which Hartford invests to purchase the funding annuity."[319]

There is some question as to the frequency of this practice occurring today. As one attorney puts it, "Today, only a very naïve attorney would not insist on knowing the cost of the proposed settlement on behalf of a client. Unrepresented claimants, however, might still be

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ing in physical injury or physical sickness."); see also I.R.S. Priv. Ltr. Rul. 83-33-035 (May 16, 1983) ("[Y]ou will have neither actual nor constructive receipt, nor the economic benefit of the present value of the amount invested in the annuity, and the periodic payments will be excludable from your gross income under section 104(a)(2) of the Internal Revenue Code.").

313. Risk, Structured Settlements, supra note 19, at 894.

314. Id. at 895.

315. Id. at 881.

316. Id.

317. Id. at 882.

318. Plaintiff's Class Complaint at ¶ 41, Doc. 1, Spencer v. Hartford Fin. Serv. Group, (No. 3:05-cv-01681-JCH) (D. Conn. Oct. 31, 2005). The complaint alleges that Hartford's liability carriers "typically do not reveal to injury claimants (or their attorneys) any information about the commission agreements they have with their appointed brokers." Id.

319. Id. at ¶ 43.

misled and taken advantage of by this tactic."[320] Thus, the occurrence of this strategy, as opposed to the subsequent two, may be rare.[321]

2. Defendants' Insurers Can Profit from Structured Settlements

Where the casualty insurer is part of a larger insurance company, which also holds a life insurance company, the insurer can profit by purchasing an annuity from its affiliate. Plaintiff representatives report cases of defendants' insurers refusing to structure a settlement unless the annuity was purchased from the company's approved list of life insurance companies.[322] Unfortunately, that list might exclusively consist of affiliate companies, and non-affiliated companies with substandard annuities.[323]

Internal insurer memos published show that some insurers have done their best to purchase from affiliates in the past.[324] Where the

320. Risk E-mail, supra note 303.

321. See Meligan E-mail, supra note 304 (suggesting that it is "rare").

322. E-mail from Lawrence Grassini, Partner, Grassini & Winkle, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 20, 2009, 15:07:38 EST) (on file with author) [hereinafter Grassini E-mail] (noting a case within the last few years); E-mail from Ritch McBride, President, Plaintiff-Quote.Com, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 23, 2009, 14:46:22 EST) (on file with author) [hereinafter McBride E-mail].

323. Grassini E-mail, supra note 322 (discussing such a case); McBride E-mail, supra note 322. One might respond that liability insurers would always wish to find the best priced annuity so as to limit costs. However, some argue that the benefit of directing business to an affiliate or friendly life insurance company is sometimes greater. Id. Life insurance companies' approved lists are sometimes available. For example, AIG's 2007 list of approved life insurance companies included its two affiliates, American General Life Insurance Co., American International Life Assurance Co. of NY, and four other life insurance companies: Allstate Life Insurance Co., Hartford Life Insurance Co., New York Life Insurance Company, and Pacific Life and Annuity Co. Robert Peahl & Michael Miller, Webcast Seminar, Single-Claimant 468(B) Trusts, http://web.aig.com/2007/lit6458/lit6458_AIG468(B)%20Presention_v2.PPT (last visited Feb. 19, 2010).

324. E-mail from Nacado King to Alfred W. Bodi et al., cc to Kharyne Neptune, Contemporary National Director of Structured Settlements, AIG (Mar. 5, 2005, 09:44 AM), available at http://www.settlepro.com/data/AIGSSPolicyMemo.pdf (emphasis added) ("Our recommended quoting practice is as follows: Our preferred method of negotiating a case is to make all offers in the form of a structured settlement. . . . When the case settles for an agreed upon dollar value with the understanding that a portion of the settlement will be placed in a structure, then the broker should place the premium with AG or AI Life. Unless compelled by the plaintiff or the plaintiff's broker to illustrate competitiveness, the broker need not canvas [sic] the Approved Life list for the best quote. If compelled, the broker must canvass the Approved List for the best available rates. The broker, however, must give AG or AI Life the last right of refusal."). It is unclear if the policy is still in effect. The author has spoken to some in the industry who believe the policy to remain unchanged. Others say that while there may have been historical significance to the memo at one time, there have

market is not fully searched, the claimant can end up with an inferiorly rated annuity.[325]

Even if the casualty insurer is not part of a larger insurance company, it can profit by structuring a settlement through the chosen broker. Since 1979, liability insurers have developed relationships with structured settlement brokers and brokerage companies.[326] A liability insurer might almost exclusively hire those particular brokers,[327] refusing to structure a settlement unless their broker is used.[328] In exchange for this business, it has been reported that brokers will often share their commission on annuity purchases for structured settlements with the liability insurer.[329]

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been substantial changes at AIG since. Darer Interview, supra note 227. Therefore, Darer asserts, those utilizing and relying on the memo are "doing their readers a great disservice by implying that the same exists today." Id. Still, there are casualty insurance companies today who strongly push to use affiliate life insurance annuities. Id. But see Ulman E-mail, Feb. 16, 2009, supra note 39 (stating that liability insurers are "often indifferent" to the identity of the life insurer whose annuity contract funds the settlement, assuming that the insurer has strong ratings). However, some argue that this may not be a problem provided that the affiliated company offers a structured annuity with a competitive rate-of-return, has a good balance sheet, and can meet plaintiff's diversification objectives. Darer Interview, supra note 227. Unfortunately, casualty companies sometimes push for the use of an affiliate that does not meet such needs. Id.

325. McBride E-mail, supra note 322 (saying that a lesser quality annuity will "often" be the result); Darer Interview, supra note 227 (stating that the use of an approved list will "sometimes" be problematic).

326. Risk, Structured Settlements, supra note 19, at 879.

327. Id. A class action against Hartford Financial Services Group alleges that Hartford and its approved brokers failed to disclose to claimants that Hartford recaptures brokerage fees by "secretly bundling the broker's four percent (4%) commission into the represented annuity cost. Nor does Hartford reveal that even if a portion of this four percent (4%) 'built-in commission' is not paid to the Approved Broker or In-House Broker, for whatever reason, it is still kept by Hartford for itself." Plaintiff's Class Complaint, supra note 318, at ¶ 44, Doc. 1. Of course, as Hartford argues in its motion to dismiss, plaintiffs do not allege that they received less compensation than promised. Defendant's Motion to Dismiss, 2–3, Doc. 28-3, Spencer, No. 3:05-cv-01681-JCH (Feb. 1, 2006). Their claim, rather, is that Hartford misrepresented the cost of making the promised compensation possible. See id. It has also been reported that claimants are sometimes sent a copy of checks made out to life insurance companies, though a portion of those checks will be refunded. Risk, Structured Settlements, supra note 19, at 888. In addition, the factoring industry has alleged that "illegal kickbacks and rebates [were given by] structured settlement brokers in exchange for directing business to said brokers." 1999 Hearing, supra note 15, at 29 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

328. Grassini E-mail, supra note 322; McBride E-mail, supra note 322.

329. 1999 Hearing, supra note 15, at 29 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

3. Defendants Can Capture Some of the Tax Subsidy

As noted, the greatest advantage of structured settlements for defendants is the ability to pay less.[330] The tax subsidy renders structured settlements more valuable to plaintiffs, perhaps by 20% or more, than their cost to defendants.[331] However, while it is claimant who will directly benefit from their increased value, defendant can indirectly benefit by demanding a decreased settlement payment.[332] Depending on the size of the reduction in defendant's cost, the claimant may reap all, or none, of the tax benefit. While plaintiffs benefit from the exclusion,[333] defendants do as well.[334] Moreover, some observe that defendants leverage their negotiating power, threatening to withdraw the option of a structured settlement in order to benefit from controlling the selection of the structured settlement annuity provider and broker.[335] Thus, the subsidy increases the chance of profiting through the purchase of the annuity, as described in Part IV.A.2.

B. Defendants' and Liability Insurers' Capture May Detract from the Subsidy's Goal

While encouraging the defense to make larger and periodic payments to plaintiffs is consistent with the tax subsidy's purpose, as doing so decreases the likelihood of plaintiffs' later dependence on the government, reducing defendants' damages is likely not consistent.[336]

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330. Andrada, supra note 36, at 471–72.

331. E-mail from William L. Neff, Partner, Hogan & Hartson LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 6, 2009, 11:48:12 EST) (on file with author) [hereinafter Neff E-mail, Feb. 6, 2009] (offering a generally used estimate of savings, stating that "the present value of the stream of tax free earnings is approximately 20% higher . . . than developing the same stream of payments if the earnings were taxable").

332. Some refer to this strategy as the "Section 130 veto." Risk E-mail, supra note 303 (noting that he coined the term "to describe the leverage defendants and their liability insurers traditionally use to coerce claimants into submitting to structured settlements controlled by the tortfeasors or their liability insurers, through intimidation by threatening loss of benefit. If the claimant refuses a structured settlement offer by a defendant or its insurer, seeking to have the claimant's own chosen structured settlement producer handle the transaction, the defendant or its insurer often will then tell the claimant that the entire settlement will be paid as a cash lump sum.").

333. See WOOD, TAXATION OF DAMAGE AWARDS, supra note 306, § 7.24.

334. Risk, Structured Settlements, supra note 19, at 872.

335. Risk, A Case, supra note 7, at 673; see Meligan Interview, supra note 31 (describing how defendants or their casualty insurers will sometimes make one structured settlement offer if plaintiff will agree to using the casualty insurer's life insurance affiliate, and a lower value offer if plaintiff refuses).

336. This is not to suggest that it is in the interest of public policy to increase defendants' payments, merely that decreasing defendants' payments below the value of the harm caused is not, in and of itself, in the interest of public policy.

While this is elaborated upon below, it should also be remembered that any augmentation of plaintiffs' financial ability to cover future needs likely furthers the subsidy's goal.

When considering whether to act in a given way, a logical person will weigh possible advantages and disadvantages. A tortfeasor employer, for example, considering whether to implement costly safety measures, considers the savings and potential damages of that decision. Where the potential damages are slight, such an employer will more readily disregard safety measures.[337] Simply put, "the incentive to take care will be reduced."[338] For this reason, some argue, "Making the defendant pay for the full harm is required [to fully achieve] deterrence."[339] The structured settlement tax subsidy, as shown above, reduces potential damages of tortious actions. One commentator suggests that the structured settlement tax subsidy carries the same effect as "a 'tort reform' measure that simply provide[s] that the federal government would reimburse tort defendants for 20% of their costs . . . structures are not actually used to provide plaintiffs with greater recovery, but to diminish the liability of their injurers."[340] Of course, the reduction in deterrence will impact risk-takers' actions at the margins, and it is impossible to know how much. However, in creating or maintaining a tax subsidy with the effect of reducing deterrence, Congress must be sure that the advantages for public policy outweigh the detriment of reduced deterrence.

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337. See generally Gary T. Schwartz, W. Page Keeton Symposium on Tort Law: Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice, 75 TEX. L. REV. 1801, 1803 (1997) (noting an "explosion of scholarship analyzing tort law in economic terms and emphasizing deterrence as a primary tort objective") (citing FOUNDATIONS OF TORT LAW (Saul Levmore ed., 1994)).

338. Smith, supra note 56, at 1973.

339. Id. at 1973, n.59 (2002) (citing David D. Haddock et al., An Ordinary Economic Rationale for Extraordinary Legal Sanctions, 78 CAL. L. REV. 1, 44–45 (1990)).

340. Scales, supra note 2, at 887. One could also analogize to defendants' ability to obtain the general deduction available for damages paid to plaintiffs. See Blackburn, supra note 61, at 687 ("If a payor is allowed to deduct damages paid, including costs of litigation, then the payor is allowed to spread such costs to the federal government and taxpayers. Furthermore, wrongdoers, just as other taxpayers, factor in the after-tax cost of their actions in shaping their behavior. Allowance of deductions for damage payments in many instances clearly frustrates public policy."). Revenue rulings go even further, allowing the deduction of punitive damages resulting from the ordinary conduct of business. Rev. Rul. 80-211, 1980-2 C.B. 57. Of course, there are exceptions and limitations. See I.R.C. § 162(f) (2006 & Supp. II 2008) (disallowing deductions for fines and government penalties for violating the law); I.R.C. § 162(g) (2006 & Supp. II 2008) (limiting deductibility of certain antitrust judgments and settlements).

Two arguments are made positing that defendants' paying less is not problematic, or at least not overly so. Some argue that it is "logically unnecessary"[341] for defendants to pay exactly what plaintiffs receive because defendants' costs are irrelevant to a compensated plaintiff.[342] However, the argument incorrectly assumes that plaintiffs' monetary compensation is the single driver of personal injury lawsuits.[343] In fact, multiple surveys have found that personal injury claimants are often pursuing non-monetary goals.[344] These include the seeking of an explanation, an apology, public vindication, or the chance to have one's side heard and respected.[345] Anecdotal evidence among personal injury trial attorneys affirms the observation that money is not often claimants' sole objective.[346] The knowledge that a defendant paid for the damage caused may be an end in itself for a plaintiff.

Some commentators also argue that the reduction in defendants' costs can benefit the public at large through reduced insurance premiums. Because liability and casualty insurers pay less, they can charge their clients less.[347] However, this argument ignores the negative impact on deterrence discussed in this section. While lower insurance costs would benefit those paying insurance, it would reduce the disincentive to take risks. The price of insurance is based on the risk of causing harm. Where the tax subsidy decreases the price per unit of risk, some individuals will take on risk that profits them less than it costs society.

Thus, public policy dictates that where possible, and where doing so does not decrease the use of structured settlements, the monetary

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341. Joseph M. Dodge, Taxes and Torts, 77 CORNELL L. REV. 143, 172 (1992) (noting that a personal injury represents the loss of human capital by plaintiff, without a proportionate gain by defendant, such as in a rescission or unjust enrichment case).

342. Derek A. Cave, Structured Settlements: An Alternate Resolution of Claims Involving Death or Substantial Personal Injury, THE ADVOC. 331, 332 (June–July 1979); see Scales, supra note 2, at 888.

343. Scales, supra note 2, at 892.

344. Scales cites multiple sources for this proposition. Id. at 892–93, 893 n.104.

345. Id. at 892–93.

346. E.g., E-mail from Gail K. Johnson, Senior Trial Counsel, Federal Tort Claims Act Section, Department of Justice to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 20, 2009, 13:06:41 EST) (on file with author) (noting that while money "is always in the mix and therefore a motivator . . . [and] remains the typical form of 'apology' and even punishment . . . the importance of it varies").

347. Choulos, supra note 21, at 74; see A Roundtable, supra note 10, at 72 (comments of Herb Cumming); BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, 1997 WL 439544, pt. 2, ¶ 13.1, at *5 (2008).

benefits of structured settlements should be directed to claimants, rather than defendants and their liability insurers.

V.
THE NEXT STEP AWAY FROM THE TWO TAX DOCTRINES: QSFs

In response to the defendant and liability insurer tactics described above, some plaintiffs make use of a tax entity created by Congress in the mid-1980s to facilitate mass tort settlements. Consistent with the public policy perspective discussed in the previous section, the entity, a "qualified settlement fund," or QSF, enables a claimant to capture a greater portion of a structured settlement's benefit, while not discouraging the use of structured settlements.

By utilizing a QSF, a claimant can control the purchase of the annuity for their structured settlement, capturing some or all of the benefits of structuring. Claimants can ask a defendant[348] to pay a lump-sum settlement into the QSF, which acts as a "tax-free way station,"[349] assuming the defendant's liability through novation. The claimant then "negotiates" with a friendly court-appointed QSF administrator to permanently settle his or her claim through a qualified assignment, thereby satisfying the requirements of structured settlement tax subsidy eligibility.

However, where there is only one claimant, that claimant arguably obtains constructive receipt or economic benefit of the settlement monies, under a traditional understanding of the two doctrines.[350] The IRS may soon decide whether the control claimants gain through the use of a single-claimant QSF disqualifies them from eligibility for the structured settlement tax subsidy.[351] The answer is the subject of "a raging debate in the tax world."[352]

This Article argues that the IRS should apply the constructive receipt and economic benefit doctrines as it and Congress have applied the two doctrines before in the context of structured settlements: narrowly or not at all. As we will see, the tax subsidy's purpose remains effective, even in the face of such constructive receipt, and is, in fact, bolstered.

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348. As we will see, claimants can also force defendants to pay an agreed lump-sum into a QSF.

349. Robert W. Wood, Qualified Settlement Funds: A Mechanism Whose Time Has Come, L.A. DAILY J., July 12, 2009, at 6 [hereinafter Wood, A Mechanism].

350. See Part V.B.

351. Infra notes 401–403 and accompanying text.

352. Wood, A Mechanism, supra note 349.

A. QSFs: More Erosion of Tax Doctine

Section 468B of the Tax Code[353] creates a tax entity called a "designated settlement fund,"[354] sometimes referred to as a "qualified settlement fund"[355] or "QSF."[356] Defendants can make an immediately deductible payment into a QSF, which will eventually be paid out to plaintiffs.[357] Thereafter, the fund assumes defendants' liability, replacing a defendant as the party to the suit or agreement for purposes of section 130.[358] Thus, the QSF will be able to structure settlements with the claimant that will be eligible for the ordinary tax subsidy.

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353. I.R.C. § 468B (2006).

354. I.R.C. § 468B(d)(2) (2006).

355. While Congress used "designated settlement fund," I.R.C. § 468B(d)(2) (2006), Treasury used "qualified settlement fund." Treas. Reg. § 1.468B (1992). Likewise, the IRS has called trusts established pursuant to § 468B "QSFs." I.R.S. Priv. Ltr. Rul. 2001-38-006 (May 7, 2001).

356. This Article uses the language of "QSF." However, it notes some of the differences here. The Tax Code provides that a section 468B fund is "any fund . . . (A) which is established pursuant to a court order and which extinguishes completely the taxpayer's tort liability with respect to claims . . . (D) established for the principal purpose of resolving and satisfying present and future claims against the taxpayer (or any related person or formerly related person) arising out of personal injury, death, or property damage." I.R.C. § 468B(d)(2)(A), (D) (2006) (including other requirements). QSFs have less restrictions, and thus more flexibility than DSFs. ROBERT W. WOOD, QUALIFIED SETTLEMENT FUNDS AND SECTION 468B, 1-7, (2009) [hereinafter WOOD, QUALIFIED SETTLEMENT FUNDS]; see id. at 13-13. DSFs, for example, only operate for claims of personal injury, death, or property damage. I.R.C. § 468B(d)(2)(D) (2006). Thus, QSFs are used more frequently than DSFs. WOOD, QUALIFIED SETTLEMENT FUNDS, supra, at 1-8; see id. at 13-3 ("In practice, the QSF has eclipsed the DSF, making it largely irrelevant."); Robert W. Wood, Tax Management Portfolios: Tax Aspects of Settlements and Judgments, 552-3rd, A-75 (BNA) (Oct. 1, 2007) (articulating other differences, which are not necessary to delineate for purposes of this Article).

357. I.R.C. § 468B(a) (2006) ("For purposes of section 461(h), economic performance shall be deemed to occur as qualified payments are made by the taxpayer to a designated settlement fund."). Without this language, deductions could only be made as moneys are received by claimant. I.R.C. § 461(h)(2)(c) (2006 & Supp. II 2008).

358. Rev. Proc. 93-34, 1993-2 C.B. 470; I.R.C. § 130(c)(1) (2006). QSFs cannot be created for worker compensation claims. Treas. Reg. § 1.468B-1(g)(1) (as amended in 2006). The typical sequence of events to use a QSF involves: (1) either side can initiate the use of a QSF by hiring an attorney to prepare the documentation, and an administrator, often the same attorney, (2) that party petitions or moves a trial court, probate court, or government entity to establish a QSF, (3) an order establishing the QSF is entered according to Treas. Reg. § 1.468B-1, (4) a court may be required to approve the settlement, (5) the administrator creates a bank account subject to the court order establishing the QSF and the continuing jurisdiction of that court, (6) the settlement agreement is signed and the money is transferred, (7) defendants are dismissed with prejudice, and finally (8) the QSF and plaintiff establish a settlement with court approval. Qualified Settlement Fund Sequence, http://www.risklawfirm.com/files/QSFSequence10-12-04.pdf (2004).

Enacted in 1986,[359] the QSF grew out of mass tort settlements,[360] and has been used for that purpose.[361] Section 468B was legislated to make settlement payments to a personal injury class immediately deductible for defendants.[362] Though the amount defendant will eventually pay to a plaintiff class may be known, plaintiffs within the class may not yet have allocated the money amongst themselves. Section 468B allows a defendant to make an immediately deductible settlement into a QSF,[363] and extricate itself from the lawsuit via a dismissal with prejudice.[364] Thereafter, the QSF is taxed as a person,[365] and the appointed QSF administrator is in control of distributing the QSF monies.[366] Because a QSF allows the transfer of monies into a fund without the beneficiaries of that fund receiving the income for tax purposes, the authoritative treatise on QSFs describes them as "a simple trust that essentially abrogates the fundamental tax concepts of constructive receipt and economic benefit that go to the root of our federal income tax system."[367]

Under Treasury regulations issued in 1993, a QSF is established pursuant to an order by a court or government entity to satisfy tortious claims,[368] and is subject to that entity's continuing jurisdiction.[369]

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359. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1807(a)(7)(A), 100 Stat. 2085 (1986).

360. Letter from Dewey Ballentine LLP to Gregory F. Jenner, Deputy Assistant Secretary for Tax Policy, Department of Treasury, et al. 1 (Oct. 8, 2003), available at http://www.risklawfirm.com/files/DeweyBallentineltrtoSenBaucus06-29-04.pdf (authored by Stuart Odell, and Joseph K. Dowley, Former Chief Counsel of the U.S. House Committee on Ways & Means (1985–1987), representing The Pension Company) [hereinafter Dewey Ballentine Letter]; see William L. Winslow, Resolving Mass Torts with Designated Settlement Funds, 30 TRIAL 82, 82 (1994) ("special purpose funds primarily grew out of asbestos cases and other toxic tort litigation").

361. Winslow, supra note 360, at 82. In the early 1990s, QSFs were used almost exclusively for large class actions. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-4.

362. See Winslow, supra note 360, at 84.

363. I.R.C. § 468B(a) (2006). The earlier a deduction can be made, the more valuable it is to the taxpayer.

364. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-21. The QSF assumes the defendant's liability through novation. E.g., Order Establishing the Enriquez Settlement Trust and Appointing Administrator, No. 06-CA-242-11-L, i (Fla. Cir. Ct. Seminole Cty. 2008).

365. Treas. Reg. § 1.468B-2(b)(1) (as amended in 1993); WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-6.

366. Though the court has continuing jurisdiction, in most cases, judges rubberstamp distributions. See WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at viii, 2-6.

367. Id. at vii. Where there are many parties arguing over the monies in a QSF, the two doctrines may not be triggered.

368. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006). Other types of claims, such as breach of contract, are also acceptable.

Pursuant to 1993 Treasury procedure, section 130 qualified assignments can be made by QSFs for purposes of structured settlement tax subsidy eligibility because they replace the original defendant as the party to the suit or agreement for purposes of section 130.[370]

B. Capturing More Benefits Through a Single-Claimant[371] QSF

Soon after the Treasury issued the procedure allowing QSFs to produce subsidy-qualifying structured settlements, the most common QSF question became, "How many plaintiffs must participate in the compromise in order to use a designated settlement fund?"[372] Though the defense industry lobbied for section 468B's regulatory framework in the context of mass torts,[373] some plaintiff lawyers and brokers have used the entity for entirely different purposes, sometimes as a "weapon."[374] In order to prevent defendants and their insurers from monopolizing structured settlement negotiations and structured settlement benefits,[375] plaintiff attorneys argue, plaintiffs in single-plaintiff

369. Id.

370. Rev. Proc. 93-34, 1993-2 C.B. 470. See generally I.R.C. § 130(c)(1) (2006). Before 1993, it was believed that QSFs could not use section 130 qualified assignments. Dewey Ballentine Letter, supra note 360, attached memo at 2.

371. Many do not distinguish between single-claimant QSFs and those with several related claimants. Wood, TAX NOTES, supra note 45, at 74; Dewey Ballentine Letter, supra note 360, at 2 n.1 ("For the purposes of this discussion, multiple-claimant situations where settlement amounts between the defendant and each claimant have been determined prior to any payment by the defendant should be considered equivalent to single-claimant situations."); Dewey Ballentine Letter, supra note 360, attached memo at 3 n.7. In truth, it is not clear what constitutes a single-claimant controversy. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 2-40. Thus, plaintiff attorneys are advised to draft complaints with alternative claims, adding other parties when possible. Id.; HINDERT ET AL., supra note 90, § 3.08B[7] (stating that some argue that Medicare and Medicaid liens "constitute separate and additional claims for purposes of 468B funds"). QSFs established with a single injured party and multiple liens or claims are sometimes called "single party" QSFs.

372. Winslow, supra note 360, at 83.

373. NSSTA was the "principal proponent of the issuance of Rev. Proc. 93-34." NSSTA Letter, supra note 14, at 8.

374. E-mail from Michael Russell, Attorney, Garretson Firm Resolution Group, Inc. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 20, 2009, 12:18:52 EST) (on file with author), [hereinafter Russell E-mail] (noting that QSFs are also frequently used as a "weapon" to get a defendant out of the structured settlement process); Darer Interview, supra note 227 (noting that some use QSFs as a "threat during negotiations"). Some plaintiff attorneys will only use the QSF if forced to. Grassini E-mail, supra note 322 (noting the appropriateness of using a QSF where the liability insurer refuses to structure a settlement without using its inadequate list of insurance companies or chosen broker).

375. See Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, slip op., 2006 WL 3455055, at *1 (N.D. Cal. Nov. 29, 2006) (amended order) ("Plaintiffs also seek a court order establishing a qualified settlement trust . . . presum-

settlements can direct the defendants or their liability insurers to pay a lump-sum into a QSF.[376] Thereafter, plaintiffs can discuss how to settle the claim with the QSF administrator in a non-adversarial context,[377] arranging for the purchase of an annuity through their own chosen representatives. Some estimate that between 30% to 40% of structured settlement brokers, or 5% of the industry, use single-claimant QSFs.[378]

While a QSF transfers control over the structuring of a settlement to a plaintiff, a defendant might demand to pay a lower lump-sum, predicting that a plaintiff will benefit from structuring soon after. If

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ably to bypass the DOJ requirements and privately create a structured payment plan."); Meligan Interview, supra note 31 (noting that he may use a QSF to prevent defendant from profiting from the structured settlement, or being involved in planning plaintiff's future). Of course, the use of a QSF must be balanced with its costs. The creation of a QSF is more complicated than a simple structured settlement. Also, their creation will typically cost between $3,000 and $5,000. Darer Interview, supra note 227.

376. Risk, Structured Settlements, supra note 19, at 892 ("plaintiffs can take control of the structured settlement process through a QSF and leave the defense out of the picture once the money has been paid into the fund").

377. Id. at 893; Risk, A Case, supra note 7, at 657 (noting that selection of the QSF administrator is normally subject to claimant approval).

378. Darer Interview, supra note 227. Most life insurance companies will sell annuities to single party QSFs on a case-by-case basis. McBride E-mail, supra note 322; e.g., E-mail from Toni Griffin, Director of Public Relations, MetLife, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 8, 2009, 10:36:02 EST) (on file with author) (discussing MetLife's policy). But see Risk, Structured Settlements, supra note 19, at 895 (noting that very few life insurance companies will sell to single-claimant QSFs). Portions of a 2001 internal memo by John Hancock tax attorneys were published in a 2001 law article, delivering the opinion that the use of a QSF does not constitute constructive receipt "merely because [the claimant] is the single claimant." Risk, Structured Settlements, supra note 19, 896 n.160 (quoting Memorandum from Otto J. Preikszas, Jr. Counsel, John Hancock, to Christi Fried, Director of Structured Settlement (Feb. 24, 2000) (on file with author)). Those companies that do accept single-claimant QSFs on a case-by-case basis typically require a showing of more than one claim. McBride E-mail, supra note 322. However, the true single-claimant case is rare, or even nonexistent. E-mail from John Staunton, Elder Law Attorney and QSF Administrator, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law. (Apr. 20, 2009, 17:25:22 EST) (on file with author) [hereinafter Staunton E-mail]; McBride E-mail, supra note 322. Practitioners observe that there is always some issue that can be "fairly characterized" as an additional claim. Staunton E-mail, supra; see also McBride E-mail, supra note 322 (noting that any case can be characterized as a multiple-claimant case as a result of possible Medicare future interests). These are often Medicaid or Medicare liens, sometimes being "potential claim[s]." Staunton E-mail, supra; see also McBride E-mail, supra note 322; Russell E-mail, supra note 374 (observing that some attorneys use potential claims to constitute multiple claims). Some firms that act as QSF administrators will not accept QSF single party cases unless obligations that could constitute other claimants exist. Id. (noting that his firm will work hard to establish that multiple-claimants exist).

done, plaintiff would be less capable of capturing the benefits of a structured settlement. Once defendants have agreed to a lump-sum settlement payment, however, the use of a QSF, and a structured settlement thereafter, is not necessarily preventable. Though some casualty companies refuse to participate in single-claimant QSFs,[379] courts can and have ordered defendants to pay into a QSF even where not stipulated by a settlement.[380] In addition, plaintiffs can and sometimes do attempt to avoid defendants' knowledge of a QSF's use.[381] There are two steps that plaintiffs can take to guard against defendants learning of a QSF's use:[382] creating the QSF out-of-state,[383] and not directing defendants to pay to a QSF.

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379. HINDERT ET AL., supra note 90, § 3.08B[7]. Liability insurers sometimes oppose the use of QSFs because they wish to benefit from controlling the structuring of a settlement. McBride E-mail, supra note 322.

380. One commentator argues that plaintiffs cannot force defendants to pay into a QSF. HINDERT ET AL., supra note 90, § 3.08B[7] (citing Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, slip op., 2006 WL 3455055 (N.D. Cal. Nov. 29, 2006) (amended order)). Hindert correctly points to Continental Casualty v. United States, where a district court refused to create a QSF because plaintiffs could cite only to regulations, rather than law, empowering the court to do so. Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, 2006 WL 3455055, at *3 (N.D. Cal. Nov. 29, 2006) (amended order) ("As a court of limited jurisdiction this court may not create a qualified settlement account merely because a tax regulation allows the creation of such settlement accounts. Rather, plaintiffs must identify some constitutional or congressional grant of authority providing this court with jurisdiction to create unilaterally qualified settlement accounts."). Thereafter, the court delineated a way that such a QSF could be used with defendant's consent. Id. However, other plaintiffs have persuaded courts to order defendants to pay previously agreed settlement amounts into QSFs. Order Granting Motion for Expedited Relief, No. Civ. 06-1153 MCA/WDS (D.N.M. Jan. 17, 2008). Such courts have, in the past, immunized defendants from liability in the event that funds deposited into a QSF are found to be taxable. E.g., id. at I. It appears that some companies are attempting to prevent such a court order by recommending that their settlements specifically disallow the use of QSFs. Peahl & Miller, supra note 323, at 19 ("The parties agree that the proceeds shall not be payable into a qualified settlement fund ('QSF'), as defined by 26 U.S.C. § 468B or 26 C.F.R. § 1.468B-1(c)(1). No party shall either agree to or seek to obtain a consent or other court order to have any portion of the proceeds placed into a QSF at any time.").

381. Risk E-mail, supra note 303 (stating that he created this tactic and has used it in multiple cases, though declining to describe exactly how).

382. Some in the industry believe that defendants will eventually discover the QSF through the use of a court order. Darer Interview, supra note 227; Neff E-mail, Feb. 6, 2009, supra note 331. However, as the following text shows, this is not necessarily true. Moreover, even if it was, the defendant might not be able to prevent their payment from being entered into and distributed by a QSF anyway. See supra note 381 and accompanying text.

383. The QSF could also be created in the same state, but in a jurisdiction other than where the claim for damages was prosecuted, such as in a probate court that is handling the recovery of damages on the behalf of a minor.

First, plaintiffs can establish a QSF outside of a defendant's purview. Regulations do not require that QSFs be created in the same proceedings, the same court,[384] or even the same state as the tort action.[385] For example, a Florida state court created a QSF for a personal injury action filed in a district court in New Mexico.[386] The Florida court held that its broad authority as a court of general jurisdiction was sufficient to create the QSF.[387] In fact, the only other party Treas. Reg. § 1.468B-1 forces plaintiff to involve is a state entity,[388] which orders and continues to exercise jurisdiction over the fund.[389] This entity could be "the United States, any state . . . territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing."[390] As the treatise on QSFs puts it, "Virtually any federal or state governmental authority willing to do so may order, approve, and take continuing jurisdiction over a QSF."[391] However, QSFs are typically created by courts.[392] By creating the QSF in a faraway jurisdiction, the plaintiff makes it unlikely that the defendant will learn of its existence or use.

Second, plaintiff can direct defendant to pay the lump-sum settlement to a name not typically associated with a QSF. Regulations do not require that defendants' checks be made out to a QSF in order for the monies to be deposited therein.[393] In fact, some courts have created QSFs and ordered that settlement monies paid by defendants to plaintiffs' attorneys be directed into the QSF "regardless of the named

384. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-9, 2-6.

385. See Treas. Reg. § 1.468B-1 (as amended in 2006).

386. See Order Establishing the Nuñez Segregated Account and Appointing Administrator, No. 2007-538, 250, 4 (County Court at Law No. 3 of Lubbock County, Texas, Oct. 31, 2007).

387. Id. (also holding the venue to be "proper"); Order Granting Motion for Expedited Relief, No. Civ. 06-1153 MCA/WDS, Conclusions of Law 4-5 (D.N.M. Jan. 17, 2008) (holding the Texas court to have competent jurisdiction, and ordering defendants to pay into the created QSF).

388. Practitioners note that judges sometimes want the defense to be involved in the creation of a QSF. Russell E-mail, supra note 374.

389. See Treas. Reg. § 1.468B-1 (as amended in 2006). A QSF can be created in a state court while the litigation is in federal court, or by probate, bankruptcy, or administrative-type courts. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 2-6. It can also be created by an arbitration award. Id. 2-7.

390. Treas. Reg. § 1.468B-1 (as amended in 2006).

391. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-9 (citing Treas. Reg. § 1.468B-1(c)(1)).

392. Id. at 1-11, 2-5.

393. See Treas. Reg. § 1.468B-1 (as amended in 2006).

payee."[394] As courts typically order the establishment of a QSF using a plaintiff's proposed order verbatim it is not likely difficult to secure such language.[395] If the plaintiff can arrange for such a court order, the defendant may never learn of the QSF's existence or use.[396]

C. Ending the Debate Over Single-Claimant Section 468B Funds

The use of single-claimant QSFs is limited by the Treasury's ambiguous position regarding the eligibility of single-claimant QSF payments for the structured settlement subsidy. An increased use of single-claimant QSFs, which would direct structured settlement benefits away from defendants[397] and toward plaintiffs, would likely result from Treasury regulations holding that single-claimant QSFs can make use of structured settlements in the same way as multiple-claimant QSFs. Plaintiffs would therefore likely benefit from regulations formally stating that single-claimant QSF structured settlement payments are eligible for the ordinary structured settlement subsidy. As Part IV.B argued, it is in the interest of public policy to direct the benefits of structuring a settlement away from defendants and their liability insurers, and toward plaintiffs, so long as it does not decrease the number or value of structured settlements. This both maintains the influence of deterrence and augments plaintiffs' ability to cover their future financial needs.

While it is possible to argue that existing statutory, regulatory, and case law implicitly establish this rule, an explicit statement from the Treasury would prevent those considering the use of single-claimant QSFs from abstaining due to ambiguity.[398] The Treasury maintained the issue as an item in its Priority Guidance Plan from 2004

394. Order Establishing the Nuñez Segregated Account and Appointing Administrator, No. 2007-538, 250, d (County Court at Law No. 3 of Lubbock County, Texas, Oct. 31, 2007); Order Establishing the Enriquez Settlement Trust and Appointing Administrator, No. 06-CA-242-11-L, d (Fla. Cir. Ct. Seminole Cty. 2008).

395. McBride E-mail, supra note 322 (noting that courts may involve defendants if they oppose creation of the QSF).

396. No law or regulation prevents the use of such a strategy. Russell E-mail, supra note 374. However, some view the strategy as "not quite legitimate and bad business." Id. The same practitioner does note that it might be a "credible option" where the defendant insists on a lump-sum payment. Id.

397. Even some commentators who disagree that defendants regularly minimize costs via structured settlements believe that the use of a QSF to be "inherently superior to structuring with a defendant." Hindert E-mail, Aug. 17, 2009, supra note 302. In addition, such proponents of QSFs argue that they are better for defendants because they eliminate defendants' "potential future liabilities." Id.

398. Wood, A Mechanism, supra note 349 ("Although the statute itself seems to suggest that even a single-claimant QSF should work, it is best to steer clear of this controversy until it is resolved.").

through 2009.[399] While the issue is not currently in the Plan,[400] it is not likely closed.[401] Throughout this time, proponents and opponents of the rule have made recommendations to the Treasury.[402] Internal disagreement in the government has been reported,[403] and though a 2001 article found the issue "clear and unambiguous,"[404] there is also considerable disagreement in the structured settlement industry.[405] Moreover, it has been reported that some in the insurance industry have urged the Treasury not to issue guidance on the subject at all, so

399. DEPARTMENT OF THE TREASURY, 2008–2009 PRIORITY GUIDANCE PLAN 19 (2008), available at http://www.irs.gov/pub/irs-il/2008-2009pgp.pdf; Third Quarterly Update of the 2003–2004 Priority Guidance Plan, Department of the Treasury 23 (Apr. 23, 2004), available at http://www.irs.gov/pub/irs-utl/2003-2004_pgp.pdf. As of 2008, it was reported that Treasury guidance "will not promptly be forthcoming." HINDERT ET AL., supra note 90, § 3.08B[5] (citing NSSTA Letter to Members (July 23, 2004)). It has been written that the delay "has been due to diversions caused by the need for tax rulings on relief funds for natural disasters such as the recent hurricanes, floods and a tsunami, plus the departure of several key people from Treasury and the IRS." Risk, Attorney Comments, supra note 225. However, the same commentator has received reports "that the issuance of published guidance on the use of QSFs established for the benefit of a single claimant . . . is near." Id.

400. DEPARTMENT OF THE TREASURY, 2008–2009 PRIORITY GUIDANCE PLAN 19 (2008), available at http://www.irs.gov/pub/irs-utl/2009_-_2010_priority_guidance_plan.pdf.

401. See generally Jeremy Babener, Treasury Decides to Pass on Single-Claimant Qualified Settlement Fund Guidance for Now, N.C. L. WKLY., Dec. 14, 2009, at 14.

402. Letter from Skadden, Arps, Slate, Meagher, & Flom LLP to Pamela F. Olson, Assistant Secretary (Tax Policy), Department of Treasury, and B. John Williams, Chief Counsel, IRS, http://www.risklawfirm.com/files/Section130-BasicSkadden Ltrwithatch7-7-03.pdf (June 19, 2003) [hereinafter Skadden Letter] (authored by Fred Goldberg, Former Chief Counsel, IRS (1984–1986), Former Commissioner, IRS (1989–1992), Former Assistant Secretary of the Treasury for Tax Policy (1992), Kenneth Gideon, Former Chief Counsel, IRS (1981–1983), Former Assistant Secretary of the Treasury for Tax Policy (1989–1992), and Jody Brewster, Former Assistant Chief Counsel (Income Tax & Accounting, 1994–1999)); Dewey Ballentine Letter, supra note 360; NSSTA Letter, supra note 14.

403. Risk, A Case, supra note 7, at 645; Risk, Structured Settlements, supra note 19, at 896 n.156; Neff E-mail, Feb. 6, 2009, supra note 331.

404. Risk, Structured Settlements, supra note 19, at 894–95.

405. See Skadden Letter, supra note 402; Dewey Ballentine Letter, supra note 360; NSSTA Letter, supra note 14; ROBERT PEAHL & MICHAEL MILLER, SINGLE-CLAIMANT 468(B) TRUSTS (2007), http://web.aig.com/2007/lit6458/lit6458_AIG468(B)%20Presention_v2.PPT. Robert W. Wood, the author of Qualified Settlement Funds and Section 468B, writes, "The Regulations seem to allow the possibility of a single claimant QSF." WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-26. However, he recommends that the use of single-claimant QSFs be avoided because of the uncertain application of the constructive receipt and economic benefit doctrines. See id. at 2-40. It is unclear if the economic benefit doctrine applies. Id. at 2-54. NSSTA has argued since 1997 that the use of a QSF triggers economic benefit in single-claimant cases. Risk, Structured Settlements, supra note 19, at 896 (citation omitted); id. at 896 n.157.

as to maintain uncertainty.[406] Although the Treasury has not taken a clear position, there is some evidence suggesting that it favors the position of single-claimant QSF proponents.[407]

Those making the case that single-claimant QSFs should not be capable of accessing the structured settlement tax subsidy make four arguments: (1) that the legislation and regulatory structure allowing QSFs was not intended for single-claimant cases, (2) that the use of a single-claimant QSF constitutes economic benefit, (3) that allowing single-claimants to use QSFs will counteract Congress's intention to encourage structured settlements, and (4) that allowing single-claimants to use QSFs will lead to abuses of section 468B. As will be shown, the first two arguments have merit, though are ultimately unpersuasive, while the latter two arguments likely fail outright. As previously discussed, the shifting of structured settlement benefits away from defendants is in the interest of public policy. Thus, the Treasury should issue guidance or regulations holding that single-claimant QSFs can use qualified assignments to structure settlements, accessing the subsidy, in the same manner as multiple-claimant QSFs.

There is significant evidence that section 468B and its regulatory framework were intended for multiple-claimant cases. As noted, section 468B was legislated in the context of mass torts.[408] It appears that the regulatory language that proponents of single-claimant QSFs cite,[409] requiring that section 468B funds be "established to resolve or satisfy one or more contested or uncontested claims,"[410] was issued in response to a mass tort related request.[411] Moreover, NSSTA success-

406. Risk, A Case, supra note 7, at 679–80.

407. The Chief of the IRS Income Tax and Accounting Division, which is the branch assigned the issuance of the relevant regulation, has been cited as confirming "that economic benefit does not automatically occur simply because a QSF is established ultimately for the benefit of a single plaintiff." Risk, Attorney Comments, supra note 225 (citing Jeffery G. Mitchell, Branch Chief, I.R.S. Income Tax & Accounting Division, Address at a seminar sponsored by the Society of Settlement Planners (March 9, 2006)). In addition, the IRS held in a non-binding ruling that moneys transferred into four identical single-beneficiary QSFs would not constitute taxable income to the beneficiaries of the funds. I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997) (entirely ignoring the question of economic benefit).

408. See Winslow, supra note 360, at 84.

409. Risk, Structured Settlements, supra note 19, at 895.

410. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006) (emphasis added).

411. T.D. 8459, 1993-8 I.R.B. 6 (1992) ("One commentator requested that the final regulations clarify whether all potential claims must be asserted before a fund, account, or trust satisfies the requirement of § 1.468B-1(c)(2). In response to this comment, the final regulations clarify that even a single claim satisfies this requirement."). Thus, opponents argue that the "one or more" language is meant to allow a QSF to be created for a single, though soon-to-be joined, member of a plaintiff class. NSSTA Letter, supra note 14, at 9.

fully lobbied for Rev. Proc. 93-34 specifically to use section 130 qualified assignments in mass tort cases.[412] Thus, opponents of single-claimant QSFs argue, use of section 468B for single-claimant cases is misuse.[413]

However, these intent arguments face three substantive deficiencies. First, even if the original intent of section 468B and the accompanying regulatory framework related to mass tort cases, no prohibition exists against existing law applying to evolving practices and purposes.[414] Secondly, the regulatory "one or more"[415] language cited by proponents of single-claimant QSFs[416] suggests that the Treasury was aware that permanently single-claimant QSFs might follow.[417] After all, the first plaintiff of a class, having requested the creation of a QSF, might never be joined by other plaintiffs.[418] And third, though Treasury regulations disallow many particular liabilities from QSF use, such as worker's compensation claims, single-claimant cases are not in that list.[419] Thus, proponents of single-claimant QSFs argue, QSFs with any number of claimants can be created without violating section 468B and its regulatory framework.[420]

Those opposed to single-claimant QSFs argue that the economic benefit doctrine applies and is triggered by single-claimant QSF transfers, necessitating a different tax treatment than for multiple-claimant QSFs.[421] Technically, there is no "express override"[422] of the eco-

412. See id. at 9 ("In the individual tort claimant situation, there was no such need for guidance because the defendant (or its liability carrier) making the section 130 qualified assignment clearly was 'a party to the suit or agreement' under Code 130(c)(1), and hence the claimant in an individual tort situation clearly could avail himself or herself of the section 130 periodic payment mechanism already."); Dewey Ballentine Letter, supra note 360, at 2 ("The sole purpose of Rev. Proc. 93-34 was to permit qualified assignments from section 468B trusts in mass tort situations where a trust is needed to accept defendant's settlement payment and to administer the funds until the individual claims are resolved. . . . Rev. Proc. 93-34 was not written to address situations in which a single claimant is involved."); Dyer Interview, supra note 53.

413. See Dewey Ballentine Letter, supra note 360, at 1–2; NSSTA Letter, supra note 14, at 12.

414. It could be argued that such an action would contradict American notions of democracy; however, the Treasury has discretion to regulate.

415. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006).

416. Risk, Structured Settlements, supra note 19, at 895.

417. Even assuming that the "one or more" language was meant to directly respond to a mass tort related comment request, the explanation stated, "the final regulations clarify that even a single claim satisfies." T.D. 8459, 1993-8 I.R.B. 5.

418. See Risk, A Case, supra note 7, at 659 (providing a hypothetical of a building fire where only one victim is identified).

419. Treas. Reg. § 1.468B-1(g) (as amended in 2006).

420. See, e.g., Risk, Structured Settlements, supra note 19, at 895.

421. Dewey Ballentine Letter, supra note 360, attached memo at 3.

nomic benefit doctrine in the Tax Code or regulations for section 130.[423] In fact, the IRS has applied the economic benefit doctrine test in at least one section 468B trust case.[424] Moreover, the IRS has found the economic benefit doctrine to be triggered where personal injury defendant monies are paid into court ordered trusts for holding and future distribution by a "nonadverse party."[425] Lastly, if a claimant does receive the economic benefit of monies in a QSF, it would be upon the defendant's novation, and prior to any qualified assignment, which may be exempted from the economic benefit doctrine. Thus, opponents of single-claimant QSFs argue, the economic benefit doctrine applies to transfers of defendant monies to QSFs in single-claimant cases.[426]

However, there is substantial reason to doubt that the economic benefit doctrine applies to such transfers. First, with respect to the cases presented in the preceding paragraph, neither involved section 130. The economic benefit doctrine arguably does not apply to section 130(c).[427] The IRS has held that the 1988 amendment[428] to section 130(c) "was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments."[429] Thus, it is argued that Congress did not intend for the doctrine to apply to single-claimant QSFs using section 130 to structured settlements.[430] And, in fact, the IRS has previously held that money transfers into four QSFs, each with a single beneficiary, did not constitute taxable income to the beneficiaries.[431]

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422. Id.

423. Id.

424. I.R.S. Priv. Ltr. Rul. 2001-38-006 (Sept. 21, 2001) (finding that the doctrine of economic benefit was not triggered by the use of a section 468B trust).

425. Rev. Rul. 83-25, 1983-1 C.B. 116. Opponents of single-claimant QSFs also point to an IRS determination that personal injury defendant monies used, pursuant to a court order, to purchase five-year certificates of deposit at a savings and loan association in plaintiff's name, were taxable to plaintiff. Rev. Rul. 76-133, 1976-1 C.B. 34.

426. Dewey Ballentine Letter, supra note 360, attached memo at 3.

427. See Risk, Structured Settlements, supra note 19, at 895.

428. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079, 102 Stat. 3709 (1988).

429. I.R.S. Priv. Ltr. Rul. 97-03-038 (Jan. 1, 1997).

430. See Risk, A Case, supra note 7, at 645 ("Congress did not intend for the judicial doctrine of economic benefit to apply to the facts of a designated settlement fund or qualified settlement fund for the benefit of a single claimant.").

431. I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997) (ignoring entirely the question of economic benefit); Risk, Attorney Comments, supra note 225 ("Obviously, the IRS found that economic benefit did not attach simply because the QSF was established for the benefit of a sole individual.") (citing I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997)); see also I.R.S. Priv. Ltr. Rul. 2001-38-006 (May 7, 2001) (stating that in the

In addition, section 486B of the Treasury regulations states, "Whether a distribution to a claimant is includible in the claimant's gross income is generally determined by reference to the claim in respect of which the distribution is made and as if the distribution were made directly by the transferor."[432] Though this may well have been written to secure excludability of claims covered by section 104(a)(2), the "as if" language could be interpreted to suggest that the economic benefit doctrine should apply to the QSF distribution in the same way it applies to qualified assignments, i.e., it would not apply.[433] Lastly, section 468B Treasury regulations also state that money transfers to QSFs to satisfy a liability are generally not included in gross income.[434] Thus, it seems doubtful that the economic benefit doctrine applies to section 468B claimants structuring their settlements under section 130.[435]

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context of a QSF-related decision, "In order for a taxpayer to include an amount in income under the economic benefit doctrine, the amount must be set aside irrevocably, for the taxpayer's sole benefit, without restrictions or conditions based upon the occurrence of future events."). It is noteworthy that in Private Letter Ruling 2001-38-006, while the IRS cited reasons why the transfer of monies into a QSF with multiple possible beneficiaries would not constitute economic benefit to such beneficiaries, the IRS failed to list the future occurrence of the settlement between the beneficiaries and the QSF as one of the possible "future events." I.R.S. Priv. Ltr. Rul. 2001-38-006. Thus, in the single-claimant QSF scenario, the fact that there must be a settlement between the claimant and QSF might not constitute a "future event" that would prevent the claimant from receiving the economic benefit of monies transferred into the relevant QSF. It is important to recognize that, except pursuant to regulations, private letter rulings cannot be used or cited as precedent. I.R.C. § 6110(k)(3) (2006) (Sept. 21, 2001). However, the Supreme Court has stated that, "although the petitioners are not entitled to rely upon unpublished private letter rulings which were not issued specifically to them, such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws." Hanover Bank v. Comm'r, 396 U.S. 672, 686 (1962) (using a private letter ruling as evidence of a particular interpretation's validity).

432. Treas. Reg. § 1.468B-4 (1992) (emphasis added) (providing, as an example, that if the claim is for a personal injury, it would be excludable under section 104(a)(2)).

433. Nevertheless, opponents argue that even if section 130's economic benefit immunity is extended to section 468B fund distributions, the doctrine is still triggered by the transfer from the defendant to the fund. See NSSTA Letter, supra note 14, at 7 ("The lump sum payment by the defendant has come to rest in the trust in which all of the interests have merged in the claimant and over which the claimant has investment control, before an assignment can ever be made.").

434. Treas. Reg. § 1.468B-2 (as amended in 1993).

435. One could argue that because a single-claimant QSF administrator is a non-adverse party to the claimant, the claimant has control and thus constructive receipt of the monies within a QSF. However, constructive receipt violation arguments face similar deficiencies to economic benefit arguments, see Part III.D. (observing the non-application of the constructive receipt doctrine to structured settlements), though they are not frequently made. Risk, Attorney Comments, supra note 225 ("Constructive

If the economic benefit doctrine is held to apply to single-claimant QSFs, it may be triggered when a defendant transfers a lump-sum payment to a single-claimant QSF.[436] It is argued that monies paid into a single-claimant QSF are no different than a lump-sum payment made directly to claimant.[437] Such arguments highlight the lack of adverse interest or material limitation on the QSF funds.[438]

If the economic benefit doctrine were found to apply, this argument would be persuasive.[439] Though proponents of single-claimant

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receipt has not been raised as an issue in whether a single-claimant QSF can make a qualified assignment."). In addition, while a QSF administrator is a non-adverse party, they are still legally independent of the claimant, having taken a defendant's place through novation. Thus, the claimant does not truly control the QSF monies.

436. Dewey Ballentine Letter, supra note 360, attached memo at 3.

437. NSSTA Letter, supra note 14, at 6.

438. Id. at 6; Dewey Ballentine Letter, supra note 360, at 3. Proponents of single-claimant QSFs argue, "[A]s long as the QSF is established and operated according to Treasury Regulations to 'resolve or satisfy' the claim or claims, there must be a future event (the settlement with the QSF), and that [sic] blocks the claimant from having economic benefit in the QSF's assets." Risk, Attorney Comments, supra note 225. Likewise, they point to a previously cited decision defining the triggering elements for economic benefit; money must be placed in an irrevocable fund beyond the reach of the transferring party, in which the beneficiary has vested rights with receipt conditioned only on the passage of time. Thomas v. United States, 45 F. Supp. 2d 618, 620 (1999) (citing Sproul v. Comm'r, 16 T.C. 244 (1951)), aff'd, 194 F.2d 541 (6th Cir. 1952)). However, a QSF clearly is a fund. It is irrevocable. The question is whether it is beyond the reach of a defendant's or liability insurer's creditors, and whether the beneficiary's interest is vested. Proponents of single-claimant QSFs draft the QSF creation documents with language subjecting the fund to all relevant claims against the defendant, see Risk E-mail, supra note 303 (stating that he does so), and recommend that others do the same. Id. By doing so, it is argued that there is "always a potential that another claimant can surface before the assets of the QSF are distributed." Id. Thus, the QSF monies are within the reach of the transferor's creditors. Id. This argument holds so long as there truly are creditors of the transferor. If not, the contention is not necessarily false, but certainly weakened. As to the claimant's vested right to the QSF monies, the discussion of whether the QSF administrator is an adverse party becomes infinitely relevant. The single-claimant QSF proponents' argument may satisfy the technical language of "vested rights to the money, with receipt conditioned only on the passage of time." Thomas v. United States, 45 F. Supp. 2d 618, 620 (1999) (citation omitted); see Risk, Attorney Comments, supra note 225 ("In a QSF . . . the claimant has absolutely no rights to the QSF's assets until there is an agreement between the QSF and the claimant."). However, other courts may use different language, or look to the function of the QSF and hold the defendant's transfer to give a single claimant such likelihood of receiving the funds that it satisfies the term "vested rights." Id.

439. Cf. Rev. Rul. 83-25, 1983-1 C.B. 116, 117 (finding economic benefit where moneys were ordered to be paid into a trust for holding and future distribution to claimant).

QSFs note the independence of QSF administrators from claimants,[440] the non-adversarial nature must be, and is acknowledged.[441]

The third argument opponents of single-claimant QSFs make[442] is that approval by Treasury would counteract the purpose of the 1982 Periodic Payment Settlements Act:[443] incentivizing structured settlements.[444] Use of QSFs by single-claimants will remove the defense from the structured settlement process.[445] Opponents of single-claimant QSFs assert that the defense's stake in that process promotes the use of structured settlements; "The practical reality born of industry experience is that, as a result [of Treasury approval], fewer physical injury cases will be settled on the basis of a structured settlement."[446] In addition, opponents argue, once defendant moneys are paid into a section 468B fund in a single-claimant case, "history shows that with a lump-sum in hand the temptation is likely to be too great in a significant number of cases, such that recoveries are likely to be prematurely dissipated."[447] Thus, because defendants will decreasingly promote structured settlements, and because single-claimant QSFs will often pay lump-sums to their beneficiaries, it is argued that regulations allowing single-claimant QSFs to access the structured settlement subsidy would thwart Congress's attempt to increase the use of structured settlements.

However, the argument that such regulations would result in fewer structured settlements is unpersuasive.[448] In fact, the use of QSFs may increase the use of structured settlements as a consequence of having additional time to consider structured settlement alterna-

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440. See Risk, A Case, supra note 7, at 661; see also Risk, Structured Settlements, supra note 19, at 895.

441. See Risk, A Case, supra note 7, at 657.

442. NSSTA Letter, supra note 14, at 1 (Approval "would significantly reduce the use of structured settlements to resolve the claims of physically injured claimants, and would thereby undermine the longstanding legislative policy to promote structured settlements.").

443. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605 (1983).

444. See Part II.C–E.

445. Risk, Structured Settlements, supra note 19, at 892; NSSTA Letter, supra note 14, at 4.

446. NSSTA Letter, supra note 14, at 4.

447. Id. at 4–5. QSFs do sometimes pay out lump-sums. Staunton E-mail, supra note 378; Russell E-mail, supra note 374 (noting that QSFs typically involve a structured settlement); Grassini E-mail, supra note 322.

448. Wood, TAX NOTES, supra note 45, at 74 ("Plaintiff brokers and defense brokers alike will still want to sell annuity policies to earn commissions. Whichever type of broker is involved, the broker will surely want an annuity to be purchased.").

tives.[449] Claimants sometimes decline the structured settlement option because they lack the time to understand its complexities, choosing instead the simple form of a lump-sum.[450] The tax subsidy's incentive is not weaker simply because the structuring is done with a QSF rather than a defendant. Secondly, it stands to reason that defendants would still have an incentive to offer a structured settlement option in many single-claimant cases.[451] Defendants or their casualty insurers have access to all of the structured settlement options available to a QSF. Since the creation of a QSF is more costly and complex, a defendant's proposed structured settlement can be more competitive. Third, while defendants may have less incentive to pursue structured settlement negotiations,[452] attorneys specializing in the administration of QSFs would likely encourage the use of single-claimant QSFs. To do so, they would certainly advertise the available tax benefits of structured settlements. Likewise, brokers who profit from selling annuities for structured settlements would also likely promote the option to plaintiffs.

Lastly, opponents of single-claimant QSFs argue that approval of their use would inevitably result in abuse of the section 468B tax entity.[453] It is proffered that tax advisors[454] and single-claimants[455] would attempt to use section 468B funds to improperly defer receipt of income. In doing so, it is argued, some taxpayers will benefit by investing pre-tax dollars.[456] Thus, opponents of single-claimant QSFs assert, Treasury should not allow access to the subsidy.

However, the abuse argument is unpersuasive. Robert W. Wood, author of Taxation of Damage Awards and Settlement Payments, and

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449. Id.; Russell E-mail, supra note 374 (noting the time-factor as the greatest QSF benefit). Contra McBride E-mail, supra note 322 (stating that the use of a QSF does not encourage the use of structured settlements).

450. Wood, TAX NOTES, supra note 45, at 74.

451. Some argue that the danger of lump-sum dissipation is no more present when monies are placed in a QSF than during settlement negotiations with a defendant or liability insurer. McBride E-mail, supra note 322. This is because in both cases the claimant does not have ready access to monies. Id. In both cases, monies will only be transferred upon a settlement agreement. Id.

452. In fact, defendants may encourage the use of structured settlements, even if paying a lump-sum. The defendant could insist on a smaller lump-sum payment by arguing that plaintiff has access to the structured settlement tax subsidy if he or she wishes to use it through a QSF. This would detract, however, from any goal of directing more benefits to plaintiffs.

453. E.g., Dewey Ballentine Letter, supra note 360, attached memo at 5.

454. NSSTA Letter, supra note 14, at 7.

455. Dewey Ballentine Letter, supra note 360, attached memo at 5.

456. It is also argued that approval of single-claimant QSFs could result in deferral opportunities in non-physical cases. Dewey Ballentine Letter, supra note 360, at 3.

the recently released Qualified Settlement Funds and Section 468B,[457] suggests that the dangers of abuse might equally exist for section 468B funds with several claimants.[458] Thus, he argues, the possibility of abuse should not "drive the debate."[459]

Proponents of single-claimant QSFs argue that the defense opposes guidance approving single-claimant QSFs in order to maintain control.[460] Opponents argue that single-claimant QSFs are used to capture annuity commissions for plaintiff brokers.[461] Because the Treasury has failed to issue guidance in response to requests,[462] there is much debate over the tax risk to claimants and their attorneys of using section single-claimant QSFs.[463] It is time for the Treasury to issue guidance specifically providing that single-claimant QSFs can

457. WOOD, TAXATION OF DAMAGE AWARDS, supra note 306.

458. Wood, TAX NOTES, supra note 45, at 74.

459. Id. Depending on the QSF administrator's willingness to delay distribution, the abuse hypothesis could prove to be accurate. However, doing so would have downsides; QSF earnings are taxable at the maximum rate for trusts, I.R.C. § 468B(b)(1) (2006), which is currently 39.6%, I.R.C. § 1(e)(2) (2006).

460. Risk, Structured Settlements, supra note 19, at 892. Through the use of QSFs, defendants would no longer participate in the choosing of annuities for the structured settlement. Risk also argues that the defense would no longer be able to use the tax subsidy as "bargaining leverage." Id., at 893. However, this argument is less persuasive. Defendants who predict or assume that plaintiff will use the QSF to structure a settlement would likely insist on a lowering of their settlement payment. Neff E-mail, Feb. 23, 2009, supra note 32. And, in fact, the possibility of using a QSF is typically introduced early in negotiations. Russell E-mail, supra note 374 (noting that the option of a QSF might not be brought up if the attorneys are not familiar with the entity). It would be possible for plaintiff to capture all of the benefits of a structured settlement, and thus for Risk's argument to bear out, if the defendant never learns of a QSFs use. As discussed in Section V.B., this can and does occur.

461. Wood, TAX NOTES, supra note 45, at 73. In truth, there is likely merit to the observation that commissions are driving much of the single-claimant QSF debate. Id. ("Much of the criticism of the single-claimant QSF, and the abuses to which some argue it is subject, is really hysteria over plaintiffs' brokers thwarting the structure efforts of defense brokers."); Wood, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 2-42; Neff E-mail, Feb. 6, 2009, supra note 331. Some in the industry have observed settlement consultants "abus[ing] the entity to grab the commissions for themselves." Darer Interview, supra note 227. In fact, settlement brokers who typically represent defendants or liability insurers sometimes oppose the use of QSFs because of lost commissions. Russell E-mail, supra note 374. See generally Risk, A Case, supra note 7.

462. See generally id.

463. See Wood, TAX NOTES, supra note 45, at 76; Risk, Structured Settlements, supra note 19, at 901 ("The risk to the plaintiff's attorney, therefore, of a legal malpractice claim brought by his or her client for allowing an adversary to handle the structured settlement for the client seems to be far greater than any tax risk claimed by the opponents of the single-claimant QSF."); Winslow, supra note 360, at 83. Some have asked, if attorneys and brokers who use them are so confident in their interpretation of the tax code and regulations, why are they asking for Treasury guidance on the subject? Darer Interview, supra note 227.

create structured settlements within the constraints of the tax subsidy, in the same fashion as multiple-claimant QSFs.

D. An Acceptable Erosion of Tax Doctrines: One Step Further on the Path

Having recounted and reviewed the available arguments for and against the IRS treating single-claimant QSFs in the same fashion as multiple-claimant QSFs, this Article concludes that doing so is in the best interest of public policy. Far more clearly than factoring, the erosion of tax doctrines for this purpose serves the substantive goal of the legislated structured settlement tax subsidy.

This Article has demonstrated the initial establishment and subsequent deconstruction of the constructive receipt and economic benefit doctrines as applied to structured settlements. At the moment, the IRS faces the next step: whether or not to deem single-claimant QSFs capable of structuring settlements with payments eligible for the tax subsidy. The use of single-claimant QSFs represents yet another level of claimant's control over settlement monies. The claimant essentially accepts the money, and can thereafter decide when and how to use it. This bears resemblance to the revolutionary change in the mid-1990s brought by the factoring transaction. Claimant was given the ability to commit to a structured settlement, but retain the power to sell the future payments at nearly any given time. At first light, it appears that the deconstruction of two tax doctrines violates Congress's original intent, and perhaps more importantly, contravenes the justification of preventing plaintiffs from prematurely dissipating a lump-sum settlement. However, allowing the ability to factor could serve the purpose for which Congress created the structured settlement tax subsidy.

What detractors of factoring fail to observe is that claimants lose the tax subsidy upon the sale of their future periodic payments. While the claimant has benefited from receiving the earnings of their preceding periodic payments tax-free, in deciding whether to factor, they must weigh the need for the upfront money against the incentive of continued subsidy availability.[464] That continued subsidy is obtained only if the claimant acts in conformance with Congress's encouragement, choosing not to factor. Of course, the high discount rates sometimes incurred may reduce the value that the claimant received from the settlement below that which he or she might have obtained by

464. The lump-sum payment from the factoring company is received tax-free. I.R.S. Priv. Ltr. Rul. 1999-36-030 (Sept. 10, 1999). However, as the factoring company cannot exclude the periodic payments as the claimant could, it will not compensate the claimant for that value.

taking a lump-sum to begin with. However, the need for money may outweigh the market price.[465] Congress's concern that a claimant might prematurely dissipate lump-sum settlement monies is only reasonable to the extent that it discourages irresponsible, rather than fast spending. Thus, factoring is not necessarily in direct opposition to Congress's original intent. What is important is that the tax subsidy operates to incentivize the use of structured settlements. Though factoring allows a claimant to sell their future periodic payments, the tax subsidy operates as a continuing incentive not to. Thus, it serves the original purpose of Congress's legislation, while allowing for actions responding to extenuating circumstances. Either way, Congress demonstrated a willingness to bend or break the doctrines of constructive receipt and economic benefit as applied to structured settlements.

Likewise, the single-claimant QSF may violate the relevant tax doctrines, but it maintains, or even bolsters the effectiveness of the tax subsidy. It is true that the transfer of defendant's monies into a single-claimant's QSF gives that claimant substantive control of the money. However, so long as the IRS treats single-claimant QSFs as it does multiple-claimant QSFs, the tax subsidy will incentivize the claimant to create a structured settlement. A claimant can choose not to use one, but he or she could make the same choice during negotiations over a structured settlement with the defendant. In fact, the time provided by the QSF may make the use of a structured settlement more likely. In addition, the use of the QSF may serve to direct a greater percentage of the tax subsidy toward the claimant, rather than the defendant. If true, the incentive to use a structured settlement would be felt more strongly by claimant in a QSF than during plaintiff-defendant negotiations.

Thus, any deconstruction of the constructive receipt and economic benefit doctrines through the use of single-claimant QSFs, when creating structured settlements, does not depart from structured settlement legislative or regulatory history. Moreover, it is consistent with Congress's stated justification for the tax subsidy. In fact, single-claimant QSFs' ability to access the structured settlement subsidy may assist the effectiveness of the subsidy itself.

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465. As noted, some factoring companies charge rates far in excess of the market price. Limitations of such rates, and perhaps increased judicial scrutiny, are likely in the interest of public policy.

CONCLUSION

This Article has demonstrated that though Congress initially established the structured settlement tax subsidy with the constraints of the economic benefit and constructive receipt doctrines, both have been eroded over many years. And, in fact, that erosion may serve the original purpose of the tax incentive: encouraging the use of structured settlements in order to discourage the irresponsible dissipation of lump-sum settlements.

After Congress passed the legislation in 1982, defendants and their liability insurers began capturing a large portion of structured settlement benefits. This works against public policy by decreasing the cost of risk-taking, and by decreasing plaintiffs' incentive to structure, except upon defendants' request. Directing those benefits away from defendants and toward plaintiffs, so long as doing so does not decrease the use of structured settlements, serves the interests of public policy.

The use of single-claimant qualified settlement funds does just that. By shifting control of the structuring of a settlement into plaintiffs' hands, and by providing more time for plaintiffs to decide whether to structure, single-claimant qualified settlement funds make the use of structured settlements more likely. The lengthened time also increases the probability that the structuring of the settlement will accurately schedule future payments to correspond with future needs. Doing so may decrease the likelihood of later factoring, and thus possible premature dissipation.

For these reasons the IRS should issue guidance stating that single-claimant qualified settlement funds are capable of structuring settlements with the resulting periodic payments being eligible for the structured settlement tax subsidy.

triggered in a Code section 130 "qualified assignment" of a periodic payment obligation for a single claimant. Such guidance has never been incorporated in the regulations.]

MS. CRISALLI: I understand.

MR. RISK: Okay, so time may be of the essence, but an additional six months.

MS. CRISALLI: Well, another possibility you might consider is suggesting, when it comes time to make comments on projects for the new business plan, that this be resurrected as a separate project, which would then allow us to propose something if it went out in a reg without delaying the other reg.

MR. RISK: Would it be appropriate to ask why it was terminated or removed from the plan after four and a half years?

MS. CRISALLI: You could ask that, but we won't answer.

MR. RISK: Okay. And I guess my response would be –

MS. CRISALLI: And nobody is supposed to know anything about that. So all these rumors you hear, you know, aren't worth the paper they're not written on.

MR. RISK: Well, it's not on the plan. I guess my immediate reaction was that because of this project, that you were going to include the guidance and that's why it was removed from the "to do" list.

MS. CRISALLI: Okay. Well, obviously that wasn't the case.

MR. RISK: Okay.

MS. CRISALLI: So if you think that this warrants our attention, you might consider, when the notice goes out around April'ish timeframe, soliciting ideas from the public, submitting a letter suggesting that we resurrect it.

Considering the preceding dialog, this request for the resurrection of this issue as a project to be placed on the "2010-2011 Guidance Priority List," is pursuant to the suggestion of Donna Crisalli, Special Counsel, Income Tax and Accounting, IRS.

When this issue was dropped from the Priority Guidance Plan in the fall of 2009, the undersigned proposed on October 1, 2009, that it could easily be resolved by a simple insertion of text into the proposed revision to the Regulations § 1.104. (Attachment 3) This explains my appearance at the February 23, 2010, hearing at the IRS. See my prepared remarks for that hearing (Attachment 4).

I originally called for the issuance of published guidance in my article, *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant,* 23 Va. Tax Rev. 639 (2003-2004). When the editor notified me in April 2004 that the final draft had been set for publication, I immediately emailed a copy of the article to several officials at Treasury and the IRS. A few days later, the topic appeared on the 2004-2005 Priority Guidance Plan. It remained on the "to do"

list until sometime in late 2009, when it was dropped without any public explanation. As Ms. Crisalli so adroitly stated at the February 23, 2010, hearing: "You could ask that, but we won't answer ... And nobody is supposed to know anything about that. So all these rumors you hear, you know, aren't worth the paper they're not written on."

Actually, the first request for published guidance had been made 10 months earlier, on June 19, 2003, by three distinguished alumni of Treasury and the IRS: Fred Goldberg, former Commissioner and Chief Counsel, IRS, and former Assistant Secretary (Tax Policy), Kenneth Gideon, former Chief Counsel, IRS, and former Assistant Secretary (Tax Policy), and Jody Brewster, former Assistant Chief Counsel (Income Tax & Accounting), IRS. (Attachment 6) The request was made on behalf of their client, the Society of Settlement Planners (not identified in the letter), of which the undersigned is a founding member and who has served that organization in various capacities. The Society of Settlement Planners is a national nonprofit educational and public policy association of professional structured settlement producers and others who assist injured claimants in the settlement process.

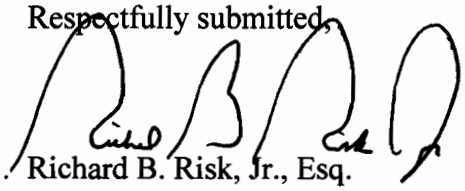
Jeremy Babener makes a compelling argument in his very recent article in the New York University Journal of Legislation and Public Policy, *Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History.* (Attachment 7) His conclusions are as follows:

> This Article has demonstrated that though Congress initially established the structured settlement tax subsidy with the constraints of the economic benefit and constructive receipt doctrines, both have been eroded over many years. And, in fact, that erosion may serve the original purpose of the tax incentive: encouraging the use of structured settlements in order to discourage the irresponsible dissipation of lump-sum settlements.
>
> After Congress passed the legislation in 1982, defendants and their liability insurers began capturing a large portion of structured settlement benefits. This works against public policy by decreasing the cost of risk-taking, and by decreasing plaintiffs' incentive to structure, except upon defendants' request. Directing those benefits away from defendants and toward plaintiffs, so long as doing so does not decrease the use of structured settlements, serves the interests of public policy.
>
> The use of single-claimant qualified settlement funds does just that. By shifting control of the structuring of a settlement into plaintiffs' hands, and by providing more time for plaintiffs to decide whether to structure, single-claimant qualified settlement funds make the use of structured settlements more likely. The lengthened time also increases the probability that the structuring of the settlement will accurately schedule future payments to correspond with future needs. Doing so may decrease the likelihood of later factoring, and thus possible premature dissipation.
>
> For these reasons the IRS should issue guidance stating that single-claimant qualified settlement funds are capable of structuring settlements with the resulting periodic payments being eligible for the structured settlement tax subsidy.

I fully endorse Mr. Babener's conclusion in asking for the issuance of such guidance, with sincere hope that the item does not languish on the Priority Guidance Plan for another four and a half years before being summarily dropped again without explanation.

I submit this request on my own behalf, not on behalf of any organization to which I may be affiliated.

Respectfully submitted,



Richard B. Risk, Jr., Esq.

Enclosures:

1. Office of Tax Policy (Treasury) and Internal Revenue Service 2004-2005 Priority Guidance Plan, July 26, 2004.
2. Unofficial transcript of February 23, 2010, IRS hearing on proposed regulations (REG-127270-06) on damages received on account of personal physical injuries or physical sickness, 2010 TNT 41-15.
3. Submission to the IRS by Richard B. Risk, Jr., October 1, 2009, re: "Proposed Rules DOCID: fr15se09-26, FR Doc E9-22221, 26 CFR Part 1, Para. 2, Sec. 1.104-19(c), compensation for injuries and sickness, published as *Attorney Suggests Changes to Proposed Regs on Exclusion of Physical Injury or Sickness Damages,* 2009 TNT 192-21.
4. Prepared remarks of Richard B. Risk, Jr., pertaining to proposed revision of 26 C.F.R. § 1.104, for delivery on February 23, 2010, before the IRS.
5. Richard B. Risk, Jr., *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant,* 23 Va. Tax Rev. 639 (2003-2004).
6. Ltr, Skadden, Arps, Slate, Meagher & Flom, LLP, June 19, 2003, to Pamela F. Olson, Assistant Secretary (Tax Policy), Department of Treasury, and B. John Williams, Chief Counsel, Internal Revenue Service, Re: Section 130 Qualified Assignments.
7. Jeremy Babener, *Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History*, 13 N.Y.U. J. Legis. & Pub. Policy 1 (2010).

OFFICE OF TAX POLICY
AND
INTERNAL REVENUE SERVICE

2004-2005 PRIORITY GUIDANCE PLAN

July 26, 2004

CONSOLIDATED RETURNS

1. Guidance under section 1502 regarding transactions involving obligations of consolidated group members.

2. Final regulations under section 1502 regarding indebtedness to nonmembers that is traceable to intercompany obligations.

3. Guidance under section 1502 regarding rate or discount subsidy payments.

4. Guidance under section 1502 regarding treatment of member stock.

5. Guidance under section 1502 regarding application of section 108 to members of a consolidated group.

6. Guidance under section 1502 regarding liquidations under section 332 into multiple members.

CORPORATIONS AND THEIR SHAREHOLDERS

1. Guidance regarding redemptions of corporate stock.

2. Guidance regarding transactions involving the transfer or receipt of no net equity value.

3. Guidance regarding selected issues under section 336(e).

4. Final regulations regarding taxable asset acquisitions and dispositions of insurance companies.

5. Guidance regarding the acquisition of businesses having certain nonqualified settlement funds.

6. Guidance under section 355.

7. Final regulations regarding plan issues under section 355(e).

8. Guidance regarding predecessors and successors under section 355(e).

9. Guidance regarding the assumption of liabilities.

10. Final regulations under section 358 regarding allocation of basis.

11. Revision of guidelines for estimating stock basis in reorganizations under section 368(a)(1)(B).

12. Guidance regarding the effect of pre-closing changes of acquiror stock value on continuity of interest.

13. Guidance regarding transfers of assets after putative reorganizations.

14. Guidance regarding statutory mergers.

15. Guidance under section 368(a)(1)(F).

16. Guidance under section 382.

17. Guidance under section 1374.

EMPLOYEE BENEFITS

A. Retirement Benefits

1. Guidance under sections 106 and 401 on retiree health accounts in a profit sharing plan.

2. Guidance on coordination with Puerto Rico law for qualified plans.

3. Procedural guidance with respect to group trusts.

4. Guidance under section 401(a)(4).

5. Guidance under section 401(a)(31) on the default rollover of involuntary distributions.

6. Guidance under section 401(b) on the staggered remedial amendment period.

7. Guidance under sections 401(k), 403(b), 415(c)(3), and 457(b) on post severance elective deferrals.

8. Final regulations under section 401(k) and (m).

9. Guidance under section 402 on the valuation of life insurance distributed from qualified plans.

10. Guidance under section 402A on Roth 401(k) elective contributions.

11. Additional guidance on the Pension Funding Equity Act of 2004.

12. Guidance on the deduction of foreign-sourced dividends by a U.S. subsidiary under section 404(k).

13. Guidance on IRA abuses.

14. Additional guidance relating to the section 409(p) requirements.

15. Guidance on amendments to suspension of benefits provisions.

16. Final regulations under section 411(d)(6) for defined benefit plans.

17. Final regulations under section 411(d)(6)(E).

18. Guidance under section 412 on mortality tables.

19. Proposed regulations under section 415.

20. Guidance on electronic communications.

21. Additional guidance on the relative value of optional forms of benefit.

22. Guidance under sections 457(b) and 501(c)(1) on plans established by federal credit unions.

23. Guidance on ESOPs.

B. Executive Compensation, Health Care and Other Benefits, and Employment Taxes

1. Guidance under section 35 on health care insurance costs of eligible individuals.

2. Guidance on secular trusts.

3. Guidance on the value of term life insurance for split dollar and pension plans.

4. Revenue ruling on tool rental.

5. Guidance under section 79.

6. Revenue ruling on section 83(b) elections.

7. Revenue ruling on timing issues under section 83.

8. Guidance on Health Reimbursement Arrangements (HRAs).

9. Guidance on the election between taxable and nontaxable benefits.

10. Revenue ruling under section 280G on section 83(b) elections.

11. Guidance under section 419.

12. Guidance under section 419A.

13. Guidance on incentive stock options.

14. Guidance on the application of SECA to Conservation Reserve Program payments.

15. Guidance on FICA and FUTA tax with respect to incentive stock options under section 422 and employee stock purchase plans under section 423.

16. Guidance on the employment tax treatment of bonuses paid to employees on the signing of a collectively bargained agreement.

17. Guidance on tips paid to restaurant employees.

18. Final regulations on the student FICA exception.

19. Revenue procedure on the student FICA exception.

20. Guidance on flat rate supplemental wage withholding.

21. Guidance under section 3504.

22. Guidance on withholding for domestic workers.

23. Proposed regulations under sections 4980E and 4980G on employer comparable contributions to HSAs.

24. Final regulations under section 9801.

EXCISE TAXES

1. Final regulations under section 4051 regarding the definition of highway vehicle in sections 145.4051 and 48.4061(a)-1.

2. Guidance under section 4051(a)(2) and (3) regarding suitability for use.

3. Guidance under section 4081 regarding the entry into the United States of taxable fuel.

4. Guidance under section 4221(e) regarding reciprocal privileges.

5. Final regulations under section 4252 regarding toll telephone services.

6. Guidance under section 4261 regarding resellers of air transportation.

7. Guidance under section 4261(e) regarding the exception for segments to or from rural airports.

8. Guidance under section 4291 regarding the duties of the collector of collected excise taxes.

9. Proposed regulations under section 6416(a)(4) regarding claims for gasoline tax.

EXEMPT ORGANIZATIONS

1. Guidance on downpayment assistance organizations.

2. Guidance on low-income housing partnerships and section 501(c)(3) participation.

3. Guidance under sections 501(c)(3) and 4958 on revocation standards.

4. Guidance under section 501(c)(15).

5. Guidance concerning the internet and unrelated business income tax.

6. Regulations under section 529 regarding qualified tuition programs.

FINANCIAL INSTITUTIONS AND PRODUCTS

1. Guidance for RICs and REITs concerning section1(h).

2. Guidance addressing the accrual of interest on nonperforming loans.

3. Final regulations under section 263(g).

4. Final regulations on notional principal contracts.

5. Proposed regulations addressing valuation under section 475.

6. Final regulations under sections 475(e) and (f).

7. Proposed regulations on the flow through of foreign tax credits for regulated investment companies.

8. Guidance on the application to foreign currency gains of the income and asset tests for real estate investment trusts.

9. Guidance on interest-only REMIC regular interests.

10. Regulations on the application of the TEFRA partnership audit procedures to REMICs.

11. Proposed regulations addressing foreign holders of REMIC residual interests.

12. Guidance under section 1256 on the definition of a dealer in securities futures contracts.

13. Guidance on credit card transactions.

14. Regulations regarding accruals for certain REMIC regular interests.

15. Guidance on system upgrade payments made to electric utilities.

16. Proposed regulations under section 7872.

GENERAL TAX ISSUES

1. Proposed regulations under section 21 regarding the credit for household and dependent care expenses.

2. Notice under section 23 regarding the credit for adoption expenses.

3. Guidance under section 32.

4. Proposed regulations under section 41 regarding internal use software.

5. Regulations under section 41 regarding the computation of the research credit in a controlled group.

6. Guidance under section 41 regarding gross receipts for purposes of computing the group credit under section 41(f).
7. Guidance under section 42 regarding the low income housing credit.

8. Guidance under section 42(h) regarding qualified contracts.

9. Guidance under section 44 regarding the disabled access credit for eligible small businesses.

10. Guidance under section 45 regarding state credit offsets.

11. Guidance under section 45D regarding the new markets tax credit.

12. Regulations under sections 46 and 167 relating to normalization.

13. Final regulations under section 59(e) regarding elections.

14. Revenue ruling regarding disaster relief payments to businesses.

15. Guidance regarding the tax treatment of repayments of Commodity Credit Corporation loans.

16. Revenue ruling under sections 61 and 162 on the proper treatment of Medicaid rebates paid by pharmaceutical companies.

17. Guidance regarding the treatment of employee relocation costs.

18. Revenue ruling under sections 121 and 1031 regarding like-kind exchanges of a principal residence.

19. Guidance under section 152 regarding the release of a claim for exemption for a child of divorced or separated parents.

20. Revenue ruling regarding the treatment of payments made by a tax-exempt organization upon its conversion to a taxable entity to satisfy its public-benefit obligations.

21. Final regulations under section 163(d) regarding the qualified dividend income election.

22. Final regulations under section 167 regarding the income forecast method.

23. Final regulations under section 168 relating to like-kind exchanges.

24. Final regulations under sections 168 and 1400L regarding the special depreciation allowance.

25. Guidance under section 168 on asset classes and activity classes under Rev. Proc. 87-56.

26. Final regulations under section 168 regarding changes in classification of property.

27. Guidance under section 170.

28. Guidance under section 172 regarding specified liability losses.

29. Guidance under section 174 regarding the treatment of inventory property.

30. Guidance under section 174 regarding changes in method of accounting.

31. Final regulations under section 179 regarding elections.

32. Guidance under section 469 regarding the limitation on losses and credits relating to passive activities.

33. Final regulations under section 1031 regarding the use of SIC codes in like-kind exchanges of depreciable tangible property.

34. Revenue ruling under section 1241 on the cancellation of lease or distributor agreements.

35. Guidance on corporations chartered under Indian tribal law.

GIFTS, ESTATES AND TRUSTS

1. Update revenue procedures under section 664 containing sample charitable remainder unitrust provisions.

2. Final regulations under section 664 regarding dividends and capital gains for charitable remainder trusts.

3. Guidance under section 664 regarding the partial or complete termination of a charitable remainder unitrust.

4. Final regulations under section 671 regarding the reporting requirements for widely-held fixed investment trusts.

5. Guidance regarding family trust companies.

6. Guidance under section 691 regarding income in respect of a decedent and deferred annuity contracts.

7. Final regulations under section 2032 regarding section 301.9100 relief.
8. Guidance under section 2036 regarding transfers with retained life estates.

9. Guidance under section 2053 regarding post-death events.

10. Guidance under section 2056 regarding qualified terminable interest property.

11. Guidance under section 2518 regarding qualified disclaimers.

12. Final regulations under section 2632 regarding election out of the deemed allocation of the generation-skipping transfer tax exemption.

13. Final regulations under section 2642 regarding qualified severance.

14. Final regulations under section 2651 regarding the predeceased parent rule.

15. Final regulations under section 2702 regarding qualified interests.

16. Guidance under section 2704 regarding the liquidation of an interest.

INSURANCE COMPANIES AND PRODUCTS

1. Final regulations under section 817 on life insurance and annuity contracts.

2. Guidance on the application of the diversification look-through rule under section 817 to tiered investment companies.

3. Guidance on the 2001 CSO mortality tables.

INTERNATIONAL ISSUES

A. Subpart F/Deferral

1. Regulations on the allocation of subpart F income.

2. Regulations under section 959 on previously taxed earnings and profits.

3. Guidance on the PFIC provisions.

B. Inbound Transactions

1. Final regulations on the treatment of portfolio stock in a U.S. insurance branch.

2. Guidance under section 1441.

3. Guidance on securities lending.

4. Guidance on the treatment of certain financial products for withholding purposes.

5. Final regulations under section 1446.

6. Regulations relating to the reporting of bank deposit interest.

C. Outbound Transactions

1. Regulations on the application of section 304 in transactions involving foreign corporations.

2. Regulations relating to the carryover of tax attributes in certain international reorganizations.

3. Regulations on mergers involving foreign corporations.

4. Other guidance on international restructurings.

D. Foreign Tax Credits

1. Regulations on the change of taxable year and foreign tax credits.

2. Regulations on the allocation of foreign taxes.

3. Regulations on the look-through treatment for 10/50 company dividends (see Notice 2003-5).

4. Guidance under section 905(c).

E. Transfer Pricing

1. Regulations on the treatment of cross-border services.

2. Regulations on cost sharing under section 482.

3. Regulations and other guidance on global dealing.

4. Other guidance under section 482.

F. Sourcing and Expense Allocation

1. Guidance on interest expense apportionment.

2. Regulations on the allocation and apportionment of charitable contributions.

3. Regulations and other guidance relating to the treatment of fringe benefits.
4. Guidance on the source of income from the cross-border use of property.

5. Regulations under sections 863(d) and (e).

6. Guidance on interest expense allocable to effectively connected income.

G. Treaties

1. Guidance on reporting and other issues under treaties.

H. Other

1. Regulations and other guidance under section 1(h)(11) on the taxation of dividends from certain foreign corporations received by individuals.

2. Regulations under section 269B.

3. Guidance on cross-border banking and insurance issues.

4. Guidance on possessions issues.

5. Regulations and other guidance concerning the treatment of currency gain or loss.

6. Regulations under section 1503(d).

7. Guidance on cross-border information reporting issues.

PARTNERSHIPS

1. Guidance regarding partnership transactions under section 337(d).

2. Final regulations under section 704(b) regarding the allocation of foreign tax credits.

3. Guidance under section 704(b)(2) regarding whether partnership allocations have substantial economic effect.

4. Final regulations under section 704(c) regarding installment sales.

5. Guidance under section 706(d) regarding the determination of distributive share when a partner's interest changes.

6. Guidance under section 707 regarding disguised sales.

7. Guidance under section 707(c) regarding guaranteed payments.

8. Proposed regulations under section 721 regarding partnership interests issued for services and the treatment of compensatory partnership options.

9. Update of the section 751 regulations.

10. Final regulations under section 752 regarding the assumption of partner liabilities.

11. Guidance under section 752 where a general partner is a disregarded entity.

12. Final regulations regarding the application of section 1045 to certain partnership transactions.

13. Final regulations under section 6031 regarding the reporting requirements of tax-exempt bond partnerships.

14. Final regulations under section 7701 regarding disregarded entities and collection issues.

SUBCHAPTER S

1. Guidance under section 678 regarding trusts that hold shares of a Subchapter S corporation.

2. Guidance under section 1363(d) regarding the treatment of LIFO recapture.

3. Guidance under section 1367 regarding adjustments in basis of indebtedness.

4. Final regulations under section 7701 on deemed corporate entity elections for electing S corporations.

TAX ACCOUNTING

1. Regulations under sections 162 and 263 regarding the deduction and capitalization of expenditures for tangible assets.

2. Regulations under section 263(a) regarding the subsequent treatment of capitalized transaction costs.

3. Update of Rev. Proc. 2004-23 regarding method of accounting changes for intangibles.

4. Revenue ruling regarding the deduction and capitalization of costs incurred by utilities to maintain assets used to generate power.

5. Regulations under section 263A regarding the simplified service cost and simplified production methods.
6. Guidance under section 263A regarding "negative" additional section 263A costs.

7. Guidance regarding the treatment of post-production costs under section 263A.

8. Final regulations under section 263A(f).

9. Regulations under section 381 regarding changes in method of accounting.

10. Revenue procedure under section 446 regarding changes in method of accounting for rotable spare parts.

11. Regulations under section 446 regarding methods of accounting.

12. Final regulations under section 448 regarding nonaccrual of certain amounts by service providers.

13. Revenue ruling under section 461 regarding the proper year for the deduction of payroll taxes on deferred compensation by accrual method taxpayers.

14. Guidance under section 468B regarding the tax treatment of a single-claimant qualified settlement fund.

15. Regulations under section 468B regarding certain escrow funds.

16. Guidance on the tax treatment of vendor allowances.

17. Revenue procedure regarding the valuation of parts inventory by heavy equipment distributors.

18. Guidance regarding the permissibility of a moving average cost method for valuing inventory.

19. Guidance under section 1.472-8 regarding the inventory price index computation (IPIC) method.

TAX ADMINISTRATION

1. Annual compilation of tax shelter listed transactions under section 6011.

2. Proposed regulations under section 6012 regarding the filing requirements for Subchapter T Cooperatives.

3. Guidance regarding information reporting under section 6041 for commissions paid to insurance agents.

4. Final regulations under section 6045(f) regarding the reporting of gross proceeds to attorneys.

5. Revenue procedure under section 6050S regarding changes in method of information reporting by eligible educational institutions for qualified tuition and related expenses.

6. Final regulations under section 6081 regarding the signature requirement to request an extension of time to file information returns.

7. Proposed regulations under section 6103 regarding the disclosure of unrelated third party tax information in tax proceedings.

8. Temporary regulations under section 6103 regarding disclosures to the Department of Commerce.

9. Proposed regulations under section 6103 regarding disclosures to subcontractors.

10. Final regulations authorizing the imposition and collection of reproduction fees for furnishing section 6104 information.

11. Proposed regulations under section 6159 regarding installment agreements.

12. Update of Rev. Ruls. 75-365, 366 and 367 regarding interests in real estate held by a decedent.

13. Guidance under section 6213 regarding math error assessments based on a Form W-2.

14. Revenue ruling regarding the classification of items and the statute of limitations under the TEFRA partnership provisions.

15. Proposed regulations under sections 6320 and 6330 regarding collection due process.

16. Revenue procedure regarding the Collection Appeals Program.

17. Final regulations under section 6334 regarding the seizure of a principal residence.

18. Revenue ruling regarding the limitations on setoff.

19. Revenue ruling regarding setoff with respect to a taxpayer in bankruptcy.

20. Revenue ruling under section 6404 regarding the application of the interest suspension provisions when a taxpayer files an amended return.

21. Revenue ruling under section 6404 regarding the remedies available to taxpayers for violations of the interest suspension rules.

22. Proposed regulations under section 6502 regarding the extension of the statute of limitations on collection.

23. Final regulations under section 6503 regarding the suspension of the period of limitations for noncompliance with a designated summons.

24. Withdrawal of the regulations under former section 6015 regarding the declaration of estimated tax by individuals.

25. Regulations under section 6655 regarding estimated tax payments by corporations.

26. Revenue ruling regarding the definition of "pending" under section 6658.

27. Withdrawal of the regulations under former section 6661 regarding the substantial understatement penalty.

28. Regulations under section 6664 amending the definition of a qualified amended return.

29. Update of Rev. Proc. 94-69 regarding qualified amended returns for CIC taxpayers.

30. Guidance necessary to facilitate electronic tax administration.

31. Revenue ruling under section 7426 regarding refund suits by third parties.

32. Revenue ruling under section 7426 regarding refund claims in lieu of wrongful levy claims.

33. Proposed regulations under section 7430 regarding miscellaneous changes made by TRA 97 and RRA 98.

34. Proposed regulations under section 7477 regarding declaratory judgments relating to gift tax valuations.

35. Proposed regulations under section 7502 regarding the timely mailing/delivery of documents.

36. Final regulations under section 7602 regarding the designation of IRS officers or employees to take summoned testimony or receive summoned information.

37. Revenue procedure regarding the early examination of questionable transactions.

38. Proposed regulations regarding third party and John Doe summonses.

39. Revisions to Circular 230 regarding practice before the IRS.

40. Revenue procedure expanding the prefiling agreement program.

41. Final regulations regarding testimony authorizations and requests for IRS information.

42. Guidance regarding frivolous arguments used by taxpayers in an attempt to avoid or evade tax.

TAX EXEMPT BONDS

1. Final regulations under section 141 on refundings.

2. Proposed regulations under section 141 regarding allocation and accounting provisions.

3. Final regulations under section 143 regarding mortgage insurance fees.

4. Revenue procedure under section 143 regarding average area purchase price.

5. Guidance on LIBOR-based swap transactions.

6. Guidance on arbitrage.

7. Final regulations under section 1397E regarding qualified zone academy bonds.

APPENDIX - Regularly Scheduled Publications

JULY 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in July 2004.

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

AUGUST 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue procedure providing the amounts of unused housing credit carryover allocated to qualified states under section 42(h)(3)(D) for the calendar year.

3. Notice providing the inflation adjustment factor to be used in determining the enhanced oil recovery credit under section 43 for tax years beginning in the calendar year.

4. Notice providing the applicable percentage to be used in determining percentage depleting for marginal properties under section 613A for the calendar year.

5. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the second half of 2004 for use in valuing personal flights on employer-provided aircraft.

6. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in August 2004.

7. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

SEPTEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2004.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period October through December 2004.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in September 2004.

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

6. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal standard mileage amounts.

7. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal travel per diem amounts.

8. Update of Notice 2002-62 to add approved applicants for designated private delivery service status under section 7502(f). Will be published only if any new applicants are approved.

OCTOBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in October 2004.

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

4. Revenue procedure under section 1 and other sections of the Code regarding the inflation adjusted items for 2005.

5. Revenue procedure providing the loss payment patterns and discount factors for the 2004 accident year to be used for computing unpaid losses under section 846.

6. Revenue procedure providing the salvage discount factors for the 2004 accident year to be used for computing discounted estimated salvage recoverable under section 832.

7. Update of Rev. Proc. 2002-71 listing the tax deadlines that may be extended by the Commissioner under section 7508A in the event of a Presidentially-declared disaster or terrorist attack.

NOVEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the "base period T-Bill rate" as required by section 995(f)(4).

3. Revenue ruling setting forth covered compensation tables for the 2005 calendar year for determining contributions to defined benefit plans and permitted disparity.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in November 2004.

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

6. Update of Rev. Proc. 2002-66 regarding adequate disclosure for purposes of the section 6662 substantial understatement penalty and the section 6694 preparer penalty.

7. News release setting forth cost-of living adjustments effective January 1, 2005, applicable to the dollar limits on benefits under qualified defined benefit pension plans and other provisions affecting certain plans of deferred compensation.

DECEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 2004.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period January through March 2005.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in December 2004.

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

6. Revenue procedure setting forth, pursuant to section 1397E, the maximum face amount of Qualified Zone Academy Bonds that may be issued for each state during 2005.

7. Federal Register notice on Railroad Retirement Tier 2 tax rate.

JANUARY 2005

1. Revenue procedure updating the procedures for issuing private letter rulings, determination letters, and information letters on specific issues under the jurisdiction of the Chief Counsel.

2. Revenue procedure updating the procedures for furnishing technical advice, including technical expedited advice, to certain IRS offices, in the areas under the jurisdiction of the Chief Counsel.

3. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of certain Associates Chief Counsel other than the Associate Chief Counsel (International) on which advance letter rulings or determination letters will not be issued.

4. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of the Associate Chief Counsel (International) on which advance letter rulings or determination letters will not be issued.

5. Revenue procedure updating procedures for furnishing letter rulings, general information letters, etc. in employee plans and exempt organization matters relating to sections of the Code under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.

6. Revenue procedure updating procedures for furnishing technical advice in employee plans and exempt organization matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division.

7. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

8. Revenue ruling setting forth the prevailing state assumed interest rates provided for the determination of reserves under section 807 for contracts issued in 2004 and 2005.

9. Revenue ruling providing the dollar amounts, increased by the 2004 inflation adjustment, for section 1274A.

10. Revenue ruling setting forth the amount that section 7872 permits a taxpayer to lend to a qualified continuing care facility without incurring imputed interest, adjusted for inflation.

11. Revenue procedure providing procedures for limitations on depreciation deductions for owners of passenger automobiles first placed in service during the calendar year; amounts to be included in income by lessees of passenger automobiles first leased during the calendar year; and the maximum allowable value of employer-provided automobiles first made available to employees for personal use in the calendar year.

12. Revenue procedure providing the domestic asset/liability percentages and the domestic investment yield percentages for taxable years beginning after December 31, 2004, for foreign companies conducting insurance business in the U.S.

13. Revenue procedure updating procedures for issuing determination letters on the qualified status of employee plans under sections 401(a), 403(a), 409, and 4975.

14. Revenue procedure updating the user fee program as it pertains to requests for letter rulings, determination letters, etc. in employee plans and exempt organizations matters under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.

15. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in January 2005.

16. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

FEBRUARY 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

3. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in February 2005.

MARCH 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice providing resident population of the states for determining the calendar year state housing credit ceiling under section 42(h), the private activity bond volume cap under section 146, and the qualified public educational facility bond volume cap under section 142(k).

3. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2005.

4. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period April through June 2005.

5. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the first half of 2005 for use in valuing personal flights on employer-provided aircraft.

6. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in March 2005.

7. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

8. Notice providing a tentative determination under section 809 of the differential earnings rate for 2004 for use by mutual life insurance companies to compute their income tax liabilities for 2004.

APRIL 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the average annual effective interest rates charged by each Farm Credit Bank District.

3. Notice providing the inflation adjustment factor, nonconventional fuel source credit, and reference price for the calendar year that determines the availability of the credit for producing fuel from a nonconventional source under section 29.

4. Revenue procedure providing a current list of countries and the dates those countries are subject to the section 911(d)(4) waiver and guidance to individuals

who fail to meet the eligibility requirements of section 911(d)(1) because of adverse conditions in a foreign country.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in April 2005.

6. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

MAY 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in May 2005.

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

4. Revenue procedure providing guidance for use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio under section 145.

JUNE 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period April through June 2005.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period July through September 2005.

4. Notice providing the calendar year inflation adjustment factor and reference prices for the renewable electricity production credit under section 45.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in June 2005.

6. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

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DEPARTMENT: Public Comments on Regulations

CITE: *2010 TNT 41-15*

LENGTH: 11528 words

HEADLINE: #15 2010 TNT 41-15 UNOFFICIAL TRANSCRIPT OF IRS HEARING ON EXCLUSION FOR PHYSICAL HARM AWARDS NOW AVAILABLE. (Section 104 -- Damage Awards/Sick Pay) (Release Date: FEBRUARY 23, 2010) (Doc 2010-4501)

CODE: *Section 104* -- Damage Awards/Sick Pay;
Section 468B -- Designated Settlement Funds

ABSTRACT: The unofficial transcript is available of a February 23 IRS hearing on proposed regulations on damages received on account of personal physical injuries or physical sickness; the focus of the hearing was on insurance companies' practices in negotiating settlements with plaintiffs.

SUMMARY: Published by Tax Analysts(R)

The unofficial transcript is available of a February 23 IRS hearing on proposed regulations (REG-127270-06) on damages received on account of personal physical injuries or physical sickness; the focus of the hearing was on insurance companies' practices in negotiating settlements with plaintiffs.

Richard B. Risk Jr. of the Risk Law Firm asked the IRS to use the proposed regs as an opportunity to clarify that *section 468B* qualified settlement funds remain tax free regardless of whether a plaintiff is aware of the amount of the settlement or is the only beneficiary of the fund.

Jack L. Meligan of Settlement Professionals Inc., representing the Society of Settlement Planners, agreed with Risk's comments. The threat of making settlement amounts taxable to the plaintiff under a constructive receipt theory has been used by insurers to discourage the use of qualified settlement funds (QSFs), Meligan said.

John S. Stanton of Hogan & Hartson LLP, representing the National Structured Settlement Trade Association, argued only that the *section 104* regs are not an appropriate place for a revision of the QSF rules.

Speakers also addressed other possible changes to the proposed regulations, including per se exclusions for amounts received for sex abuse or long-term wrongful imprisonment.
Internal Revenue Service

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TEXT:

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UNITED STATES DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

PUBLIC HEARING ON PROPOSED REGULATIONS
26 CFR PART 301
"DAMAGES RECEIVED ON ACCOUNT OF PERSONAL PHYSICAL INJURIES OR PHYSICAL SICKNESS"
[REG-127270-06]
Washington, D.C.
Tuesday, February 23, 2010

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* * * * *

PROCEEDINGS
(10:00 a.m.)

MR. MONTEMURRO: Good morning, ladies and gentlemen. I'd like to welcome you this morning to this hearing on proposed amendments to the final regulations under *Section 10482* of the code. The proposed amendments would update the final regulations to reflect the changes made by Section 1605 of the Small Business Job Protection Act of 1996. It would also delete the tort type rights test in the current regulations. The reg project number is REG 127270-06.

The next thing I'd like to do is let the panel members introduce themselves, starting at the opposite end of the table.

MS. ROSS: I'm Jeanne Ross, I'm with the Treasury Department.

MS. CRISALLI: Donna Crisalli, with Income Tax and Accounting.

MR. ISKOW: Sheldon Iskow, Income Tax and Accounting.

MR. MONTEMURRO: Mike Montemurro, Income Tax and Accounting. Okay. We have a little bit about -- some of the rules about speaking. We have three scheduled speakers today, but after I'm done with the scheduled speakers, anybody else who wants to speak will have an opportunity to speak, as well. Each speaker gets ten minutes to speak, and there's a little timer here, hopefully you can see it, you get ten minutes. I think the way the lights work is, there's a -- you start with a green light, with three minutes to go, a yellow light comes on, and then the red light comes on, sort of like traffic signals when the time is up.

I will stop the clock if one of the members of the panel has a question for the speaker, and then, you know, and that will stop the clock until that conversation is over, then we'll resume the countdown on the clock, and that's sort of what we'll do, that's the way that sort of works. I've got a beeper on, if you want a beeper on, you want the beeper on, we can figure that out, okay.

So we also have two services here transcribing the hearing, one, the Federal News Service, and one, Tax Analysts, and I think that sort of takes care of all the preliminary matters. What we'll do is, at the end of the three scheduled speakers, other people who want to speak will also have the opportunity to speak, OK. Go ahead, you have a question.

MR. MILLIGAN: I have a question. And I spoke to Mr. Iskow earlier, I had asked for 15 minutes and heard nothing to the contrary, and I've timed my presentation for that, so do I just hand over my script?

MR. MONTEMURRO: Well, I think it's ten -- I think we've said it was ten minutes, so I think that's where we are, you know. It's always a ten-minute presentation, so I think that's sort of what it is.

MR. MILLIGAN: Okay.

MR. MONTEMURRO: So I guess we'll start with the first speaker.

MR. ISKOW: Our first speaker is John McCulloch, representing Integrated Financial Settlements.

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MR. MCCULLOCH: Thank you for letting me appear today. Again, my name is John McCulloch, I work for IFS. We're a large structured settlement brokerage. We provide tax-free periodic payments for plaintiffs and defendants. Every year thousands --

MS. CRISALLI: Can you speak louder because your back is to the audience and they're not --

MR. MCCULLOCH: Do I get time out for that?

MS. CRISALLI: Yes, time out.

MR. MCCULLOCH: Every year we encounter thousands of plaintiffs who we put in tax restructured settlements, but every year we encounter groups of plaintiffs that we are not able to assist because their injuries do not fall under the strict definition of an observable physical harm, a personal physical injury or sickness under 104A2. I'm here today talking about two of those groups, victims of sex abuse and molestation and victims of long-term wrongful imprisonment.

The 1996 Act, which changed 104A2, was never meant to affect these two groups, but because of a lack of clarity, we're really not in a position to help them, and that's what we're seeking here today, is to get some clarity surrounding these two groups of claimants.

When the Small Business Job Protection Act was signed in the law on August 20 of '96, it created -- it imported that requirement that the injuries be physical to be excludable from harm. The conference committee report at 104737 at 301 specified that emotional distress injuries, even those manifesting in a physical injury, were taxable unless they originated in a physical injury or physical sickness. Therefore, the Act elevated being -- an injury being physical to a new level, but neither the Act nor the legislative history went into any detail on how do you define what a personal physical injury or personal physical sickness was.

Throughout the existence of *Section 104*, the taxation of settlements has been interpreted by the Service and the courts to reflect the character of the claim and the damages the recovery is meant to replace or compensate for.

It stands to reason that the Act, which that provision was aimed at employment damages, made those taxable. Since wage loss represents a large component, those recoveries should be taxable. Conversely, an injury settlement to replace a lost limb or the loss of a loved one, those were never items of income, and it stands to reason those are not taxable.

So was congressional intent to exclude certain types of claims or rather that the injury be distinctly physical either in its origin or its result? The conference committee report states that this provision originated in differing views the courts had on employment discrimination -- decision on age discrimination, and the Service's suspension of guidance on the tax treatment of employment discrimination claims. A direct quote from the House bill said that the intent was to change *Section 104A2* so that it did not apply to damages received based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. So while a line was drawn between physical and emotional injuries, the Act didn't define what types of claims -- what constituted physical injuries.

Nowhere in the bill or the legislative history will you find anything stating a congressional intent to tax sex abuse, molestation, or long-term wrongful imprisonment. We're now 13 years post the Act and we don't have any sort of formal guidance on what constitutes a personal physical injury.

We only have informal guidance in the form of *PLR 2041022*, which gave us the observable harm standard. So to qualify under that PLR for exemption, the injury had to have direct or unwanted or uninvited physical contact resulting in observable bodily harms such as bruises, cuts, swelling and bleeding.

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So while this standard may work for some claims, there's many claims that this standard cannot work for and shouldn't be universally applied. For example, pneumoconiosis is a physical sickness without an observable harm, you can't even see the symptoms until the latter stages of the disease, and yet no one would deny that black lung is a serious physical sickness or illness.

Similarly, tort litigation surrounding some physical sicknesses, such as the cases against Johns-Manville for asbestosis, or the diabetes cases against Eli Lilly from Zyprexa, none of those are observable harms, in fact, the symptoms aren't observable until shortly before death in some cases.

Taken to an extreme, consider a rear end collision with only soft tissue injuries, those harms are not observable, you can't even measure soft tissue injuries under x-ray or MRI, and yet those are consistently considered personal physical injuries.

So if an observable harm is not workable for those, it should not be workable and cannot be workable for sex abuse and wrongful imprisonment claims. For example, a study of 893 sex abused victims reported in the American Journal of Obstetrics and Gynecology, Volume 190, titled Physical Injury After Sexual Assault, was an analysis of urban emergency room sex assault victims. And while bruises and abrasions were the most common injury, they only represented 15 percent. Only seven percent had lacerations. Some 48 percent did not have what could be categorized as an observable trauma. Genital trauma in particular can be very difficult to document even when seen by a physician right away, which is typically not the case in these types of circumstances because of what goes on with the victim, embarrassment, shame, just the overall trauma.

So clearly, you know, we have 48 percent on average of these victims without an observable harm. I would submit to you it is improper to call these purely emotional or nonphysical injuries simply because there's not an observable harm.

The long term effects of both sex abuse, molestation, and wrongful imprisonment are well documented and long lasting. A study in the Journal of Interpersonal Violence, Volume 18, 2003, showed that victims of abuse were four times likely to commit suicide, four times likely to self-mutilate. A study of drug users showed that 42 percent had been abused as children.

A report from the Population Information Program showed that rape and childhood abuse were among the most common causes of post traumatic stress disorder, a disorder which is well understood and well documented in the medical communities, having long term physical and mental effects. Turning to long term wrongful imprisonment, according to the Innocence Project, of the 249 people they've exonerated, the average time spent in prison was 13 years.

Department of Justice study of women's prison showed that virtually every female inmate had been subjected to various levels of sexual aggression, from lewd remarks to rape, while a similar study conducted on men showed the percentage at 22 percent.

The Journal of Epidemiology reports that the long term effects of imprisonment include mental health problems, increased rates of poverty, smoking, poor eating habits, and substance abuse. A 2000 study showed that those in prison exhibited high rates of depression, chronic mental health problems, and substance abuse. The worst outbreaks in recent history from tuberculosis and HIV originated in prison populations.

I think it's without question that there are long term observable effects from both of these types of injuries. These cases were not meant to fall within the scope of the '96 Act. In deference to the very difficult tasks faced by Service and Treasury in attempting to define what is a physical injury, I would submit that for these two specific types of injuries, rather than relying upon an observable harm standard, we create a standard that would fit these cases, that the physical act of abuse or the physical act of deprivation of freedom is in itself a direct manifestation of a physical injury.

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While purely mental or emotional damages are one thing, the act of being deprived of freedom or the act of being abused is, by definition itself, an observable harm.

Turning back to the legislation intent of the Act in '96, Congress did not say that an injury needed to be observable, but what they were trying to do was raise injury claims to a certain threshold, a physical threshold, in order to distinguish it from transitory emotional distress damages, the type of which typically accompany age discrimination or wrongful termination claims.

It is interesting to note that Congress decided that once you reached that threshold, then emotional distress damages became tax free. In the past, we've seen that it's been congressional intent to create tax exemption for wrongful imprisonment with the Civil Liberties Act of 1998. Treasury has ruled in the past, in revenue rulings 56462 and 58370, that victims of -- prisoners of war, that their reparations were tax free, and the Service, in one ruling, post the '96 Act, 199906004, relied upon these rulings to rule that compensation for deprivation of civil rights and freedom was not income. Very distinguishable from short-term wrongful detainment, as we saw in the Stadnyk case, where the detainment only lasted eight hours, and the injuries were no greater than being photographed in a prison jumpsuit.

In terms of the sex abuse cases, the Service itself, a Chief Counsel advisory letter from Mr. Montemurro acknowledged the difficulties found in these cases. In CCA 2009 09001, the Service acknowledged the difficulty in showing an observable harm, the lack of medical records, and acknowledged that absent an observable harm or medical records, that they would assume that an observable harm existed, and it was exempt. And I would submit that all sex abuse cases fall and receive the same type of treatment, no less and no difference from a broken toe or a bruised leg.

Thank you.

MR. MONTEMURRO: I just will make one comment, the thing about --

MR. MCCULLOCH: -- taken your Chief Counsel advisory in vain?

MR. MONTEMURRO: No, that would be observable -- observable harm is a standard. Of course, that was, you know, in the context of one PLR, and you know, sometimes I read a lot that, you know, this is like somehow -- you have to -- in order to get 104A2, you have to be able to observe the harm currently. I would assume that, you know, if somebody were physically injured, were sick, and then they sued later, and the harm had disappeared over that course of time, I would think that that -- that's still a personal physical injury.

I mean I think we were dealing with, you know, a particular factual situation, so to extrapolate that the letter will set some sort of black letter rule, it's just a statement in the --

MR. ISKOW: It's broader.

MR. MONTEMURRO: -- in the, you know, as facts in the letter ruling that we had presented there, that's all I'd say.

MR. MCCULLOCH: Absolutely; the thing we're faced without -- in the field, so to speak, when we're dealing with injury victims, with plaintiff attorneys, with the annuity issuers that provide the structured settlements, they take an extremely conservative view, and while we know PLR's are not presidential, they certainly look at it as to what would the Service do in this situation, and they tend to err on the side of caution. But even if we set the observable harm rule advisory letter aside, it's a gray area. And insurance companies are notoriously conservative.

And, you know, absent a clear definition that sex abuse and molestation is, per se, a physical injury, as we have submitted, or that long term wrongful imprisonment is a physical injury, as we have submitted, there have been err on

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the side of caution and not take these.

And when you look at people who have been abused and people who have been wrongfully incarcerated, those are groups of people who desperately need long term financial planning, they're two groups that are the least capable of doing financial planning, they're dealing with a multitude of mental and emotional issues, the last thing they need is the added burden of trying to, you know, manage bills and invest, things that confound even the best of us.

MR. MONTEMURRO: Thank you.

MS. CRISALLI: I have some questions.

I'm trying to understand exactly what it is you're saying. Now, I assume you're not saying that someone who had a purely mental condition should be able to exclude damages --

MR. MCCULLOCH: No.

MS. CRISALLI: -- because that's not physical, but you seem to be saying that, in certain situations, we should presume that there's physical injury, for example, someone who's suffering from PTSD or somebody who's been wrongly imprisoned; is that what you're saying?

MR. MCCULLOCH: Yes; you know, rather than try and come up with a broad rule, which I would think is impossible, quite frankly, we're looking at two very, very narrow groups. So if you've been molested or abused, even though there's -- there may not be any proof of a physical injury, and, in fact, the statistics show that there is not in most cases, or if you've been in prison for a long duration as opposed to just a short transitory detainment, that those are, per se, physical injuries, with or without an observable harm.

We're not looking for exclusion on any kind of broad basis for non-physical or emotional injuries, it's those two very specific, very narrow groups of people, fortunately very small groups. On average, there's probably several hundred to maybe, at peak, 1,000 people exonerated a year. When you look at a report from the Presbyterian Church, they assume there's about 50 abuse cases annually, which is why I think this has sort of slipped under the radar. These are very small groups of folks; however, we run into them, whether on the plaintiff or the defense side. And it's incredibly difficult to sit across the table from someone whose child has been molested in a daycare and tell them that the life insurance companies that issue the -- annuities won't take this case because they're not sure it's tax free. And we're looking for relief for just those two groups.

MS. CRISALLI: Okay. Is it difficult for plaintiffs, injured people in these groups, to obtain some kind of medical documentation that there is a physical injury that's resulted from this?

MR. MCCULLOCH: Yes.

MS. CRISALLI: Even if it's like high blood pressure?

MR. MCCULLOCH: That wouldn't satisfy the life -- again, the life companies will look --

MS. CRISALLI: Okay. I'm not talking about the life companies, I'm talking about the Service. I mean if the Service said, you know, they would presumably accept it?

MR. MCCULLOCH: The problem, though, is a lot of times people don't seek medical treatment. And in the case of wrongful imprisonment, there is, you know, ultimately not going to be a treating physician for all of the impact for being wrongfully imprisoned. You can seek things later, but tying it back to the wrongful incarceration is not going to

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be successful.

A lot of times, particularly with molestation cases in schools, you'll find an incredibly low rate of physicians treating these folks, and the physicians are not going to just write up something that says you're injured for tax purposes.

MS. CRISALLI: Do you have any indication that these kinds of issues are being raised by the field, by the Service level? You're more concerned about how the insurance companies are adjusting?

MR. MCCULLOCH: We're more concerned about -- in the field, what ultimately leads up to the insurance companies and whether they can accept it. But whether you can do a structure is almost secondary to the issues -- whether these -- are these tax free or are these taxable situations. And often times when you tell a party that it's taxable, it changes the entire dynamic of the settlement negotiation. Do you have to withhold to pay taxes on what your attorneys are being paid? On these cases, if they are taxable, ANT could potentially apply, so the parties have to plan accordingly.

But the problem is not so much being raised in the field offices. Again, I think because these are small numbers of folks, fortunately, I think it would be, in one dimension, terrible if we had, you know, rampant sex abuse cases and wrongful incarceration. But there are a few hundred folks a year, but I don't think that makes it any less important.

MS. CRISALLI: The last question, do you -- can you comment on whether you think we could include a rule like this in a final regulation and be compliant with the Administrative Procedure Act that requires notice and opportunity for public comment?

MR. MCCULLOCH: I believe we could. I think this is an issue --

MS. CRISALLI: Of course you do.

MR. MCCULLOCH: Well, you asked me, and I thought there was sort of a softball, you know, pitch for me to --

MS. CRISALLI: No, it's not, it's a hardball actually.

MR. MCCULLOCH: I do, I think it's an issue that you would find a lot of support on. I don't think administratively or procedurally there would be any objections to including these as, per se, definitions of physical injury, you know, nothing would make me happier than to see that.

MS. CRISALLI: Okay. So we could do it because nobody would care?

MR. MCCULLOCH: No, I think you would do it because you would find that a lot of people care and you would not find objection?

MS. CRISALLI: Nobody would object?

MR. MONTEMURRO: Let me just ask you a question. So you set it at one year, so the guy who is in prison for 11 months, if we say that that's -- if we say that one is a physical injury -- implication going to be that the one 11 months is not a physical injury. Right now no one says that it is or isn't, so that guy is going to be, you know, potentially in a worst position, right?

MR. MCCULLOCH: Potentially, but you have to draw the line somewhere, and it's not an enviable task.

MR. MONTEMURRO: That sort of goes back to Donna's question, that guy with 11 months, he's going to be reading that reg saying, wait a second, I didn't have an opportunity to say get it down to six months, or three months, or two

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months or --

MR. MCCULLOCH: Possibly, but when you look at the -- again, turning back to the data that is available from the Innocence Project, these are not people on death row for 11 months, these are people on death row for over a decade. And I tried to draw the line, as the Service has in other circumstances, capital gains, for example, the difference between short term and long term is a year, it seemed like a good place to draw it.

MR. MONTEMURRO: Congress drew that line, though.

MS. CRISALLI: Well, that kind of gets to my -- well, I said that was my final question, I found another one. Have you talked to them up on the Hill about this?

MR. MCCULLOCH: No, not yet.

MS. CRISALLI: You might think about it.

MR. MCCULLOCH: I will.

MR. MONTEMURRO: Okay.

MS. ROSS: I have a question. I mean you're proposing that we draw the line around the sexual abuse cases and these wrongful termination cases.

MR. MCCULLOCH: Wrongful imprisonment.

MS. ROSS: Wrongful imprisonment, thank you. And I think you said at the beginning of your testimony that it's hard to make the distinction between physical and non-physical, and you think, correct me if I'm mischaracterizing what you're saying, but I think you said that you don't think that distinction can be made and that's why you are proposing to carve out these two groups here; can you say more about why you don't think we could clarify what we mean by physical injury?

MR. MCCULLOCH: Well, in looking back to the employment cases that led to the '96 Act that changed 104A2, you are looking at a lot of emotional distress, mental anguish claims and suits being brought, you know, being incorporated into wrongful termination type suits, and as I look at those, it's hard to know where to draw the line on the emotional distress, mental anguish issue in terms of just overall what you would call non-physical injuries. You know, certainly, if the Service wanted to make non-physical injuries excludable as they were back in the pre-'96 days, you know, that would be beneficial to a lot of folks, but I think you run up against congressional intent, which was to close the door on excludability for employment cases.

So in trying to be consistent with congressional intent and understanding that it is a very difficult task, you know, you would face in trying to carve out or trying to define physical injury, you know, we looked at, you know, one of the two most egregious instances of where we're just unable to help folks, or that there's just big questions of whether they're taxable or tax free.

So that's why we drew the line around these two particular types of cases. These are the sets of taxpayers most in need. You know, I think, looking at what Congress was doing, they wanted to make sure it wasn't transitory, that these injuries rose to a specific threshold so that they weren't just added in to get exclusion from taxation.

And I think with molestation abuse cases and long term wrongful imprisonment cases, you know, these are not people that are adding emotional distress and mental anguish or non-physical elements to get excludability, two very distinct

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groups of folks, you know, and those are the two I'm here arguing for. I mean if we were arguing about excluding all non-physical injuries, I think I would be making very different arguments today.

MR. MONTEMURRO: It has nothing -- in a narrow sense, what you're asking is, these folks who have suffered these injuries, I mean they're not reporting these as taxable income, I'd assume; the question is whether the insurance company will let them structure, rather than take it as a lump sum, whether they can take the money over, you know, 20 or 30 years.

Because I mean I don't know that the Service has ever gone to court on litigation, you know, I know the Service doesn't ever go to court on litigation, anybody who's been falsely imprisoned or anyone who's suffered any sex abuse, as far as asserted in a courtroom that those kinds of damages are taxable, I mean whatever the pure technical answers may be, but I'm saying I don't know that taxpayers are reporting these as taxable damages themselves, it's the matter of whether you go to the insurance company and they'd be willing to structure it, instead of the lump sum payment that comes over time.

MR. MCCULLOCH: That's a hard one to answer. The statistical data isn't there. All that you really have is anecdotal data. For example, the Dallas Star reported when David Pope was freed, you know, they gave him a lump sum, and he actually -- interviewed him, because nine months later he dissipated it all. And the interesting thing, there is a mention in there, almost cursory, about, you know, how it was taxed. It almost is like they were going in the direction of, look, the state with the left hand compensates you for throwing you in jail, and with the right hand, takes it back in the form of taxation, there's an inequity there.

I think the wrongful imprisonment cases are being reported as taxable income; the abuse cases may or may not. I looked, I've done exhaustive research, I could not find the data there.

The Catholic Church and the Presbyterian Church were understandably reluctant to share data about whether they're doing 1099 miscellaneous reporting on these settlements, for example. So, Mr. Montemurro, I tend to agree that they're probably not, but the issue is that these taxpayers shouldn't have to worry. It should not be a roll of the dice whether your settlement is tax free or taxable. You should know if your abuse case or your wrongful imprisonment case is going to be reported and taxed.

MS. ROSS: I just want to make sure I understand what you're saying.

MR. MCCULLOCH: I'm from Chicago, our goal is to dance around the question and talk as fast as possible

MS. ROSS: You're asking for per se rules here. Is your position that they should -- that sexual abuse and wrongful imprisonment cases should come in because they are physical injuries?

MR. MCCULLOCH: Yes.

MS. ROSS: Or that they are non-physical injuries that are at the extreme end of the spectrum, and therefore, should be treated as if they were physical injuries?

MR. MCCULLOCH: I think in the case of wrongful imprisonment, the latter is true. I think in the case of sex abuse, they are -- it's the former. Just because you can't see the impacts of an abuse or a rape doesn't mean it's non-physical.

I think with the wrongful imprisonment, it is -- you're being confined, your civil rights have been deprived, that in itself is a physical act, but when you look at the statistical data from the Journal of Epidemiology, the World Health Organization, lots of long term repercussions that even now are not fully understood, but we know that these folks commit suicide at a high rate, drug abuse, substance abuse, mental health, personality disorders, and I think that is very

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distinguishable from a transitory emotional distress from being fired, or detained in a department store for a few hours because somebody accused you of being a shoplifter or something like that.

I think, as you say, it's on the extreme end of -- and I hate to use the word non-physical, I don't think it's an accurate word, I just think it is a -- rather than having the physical injury itself be physical, the act itself is physical, and a lot of the repercussions and effects are physical.

MR. MONTEMURRO: I mean that's the sort of thing -- do we do a carve-out, because there will be other situations. You could have a stalker, you know, terrorizes somebody, it never touches them, calls them on the phone, takes pictures of their kids, I know where your kids are, and that person could suffer long term, you know, is that physical, never touched them, you know, just called them, but that, you know, I mean there's -- that's always been the problem with this statute. And you've got -- so I don't know whether we want to say, well, we'll treat these two because then other folks will say, wait a second, what about this situation, what about the nine month guy, what about the stalker, what about people who are, you know, falsely -- wrongfully imprisoned, not by the state, but by a kidnapper for three or four days, maybe that happens to a child or an adult --

MR. ISKOW: Hostage.

MR. MONTEMURRO: -- yeah, a hostage, maybe they're released and maybe they were treated well while they were a hostage, but they may be still in terror of their -- of dying or being killed, you know, and you know, well, that person, though, that guy -- his, you know, if we say this one, false imprisonment in a real prison required by state law because you're falsely imprisoned by the state, that's physical, but the guy who may be kidnapped or held hostage for a couple of days by some, you know, kidnapper, well, that guy is, you know, he gets the negative implication.

That's sort of the problem of sort of cutting out two nice little safe harbors, if you want to call it, and then the other folks are still there, and you know, we still may be faced with those as an administrative matter, may accelerate those questions or exacerbate those questions more than we have now.

MR. MCCULLOCH: You know, great points, you know, especially I think this week on -- you had a book about the long term hostages down in Colombia for the three independent contractors, but that's the problem, you know, that the service and Treasury faces, how do you open the door a little bit without throwing the barn doors wide open, which is why we went for these very narrow specific situations, but they tend to be the most frequent.

I mean we do, you know, we are the largest structured settlement, you know, group of brokerage companies, we run into thousands of situations every year, and these are the two that we see that are the most prevalent.

You know, I've been doing this about 15 years, and I've only run into one kidnapping case, but we were, you know, heavily involved in the LA Archdiocese, with some of the Presbyterian Church, we were involved with some of the folks wrongfully incarcerated in Texas, trying to set up taxable periodic payments.

You know, I think those other situations are more one -- and I think can, you know, be addressed by informal calls for guidance, for example, to the field or national office, even private letter rulings. But I think that there's a sufficient number of abuse molestation victims and wrongful incarceration victims that it warrants these two separate -- if you will.

MR. MONTEMURRO: Okay, very good. Thank you.

MR. MCCULLOCH: Thank you.

MR ISKOW: Our second speaker is Richard Risk, who is representing himself.

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MR. RISK: Thank you. And as I -- before the clock starts, as I mentioned here, I had prepared comments for about 15 minutes, and I'm going to skip through a lot of this, and so if the -- is not correct, it's because I left out large blocks of what I had prepared to say, unless the Chair would grant the extra five minutes. Can't do?

MR. MONTEMURRO: No, I can't.

MR. RISK: Okay.

MR. MONTEMURRO: Everybody, you know, that was the, you know, the public announcement was ten, so --

MR. RISK: All right. Well, ladies and gentlemen, Mr. Chairman, thank you very much for the opportunity to appear. My name is Richard B. Risk, Jr., I reside in Tulsa, Oklahoma and St. Petersburg, Florida. I'm an attorney whose entire law practice focuses on the aspects of tort claim settlements. I've written documents to establish more than 250 qualified settlements funds and have administered the majority of them. I've been published extensively in legal journals and have chaired tax panels for professional associations, the Society of Settlement Planners, including guest panelists from Treasury and the Internal Revenue Service. I'm appearing today on my own.

Structured settlements are a very important tool in the resolution of satisfaction of claims originally asserted by injury victims against the tort -- after the liability for such claims has been transferred by novation to the qualified settlement fund. I'll get to the tax issues in a few minutes, but first I want to present a little background of the undercurrent within the structured settlement industry that may serve to explain why we may have differences of opinion among ourselves as to how the tax codes should be interpreted.

I first came into the structured settlement community in 1986 as a producer, and eventually joined the National Structured Settlements Trade Association because it was required of anyone who sought to be appointed by the major annuity markets. At the time I joined the Trade Association, the marketing orientation for structured settlements was almost entire from the defense side. Structured settlement producers worked with corporate risk managers and liability insurance claim adjustors to propose periodic payments to injury victims, along with the attractive tax subsidy, as a way the responsible party could save money and settle claims.

If a claimant or claimant's attorney wanted to know the cost of the funding asset, the annuity, the response was that knowledge of the amount that caused the claimant to be in constructive receipt of the funding asset, and thus would lose the tax benefits.

If the claimant felt uncomfortable, allowing the structured settlement producer engaged by the defendant to handle perhaps the biggest financial transaction of their life, and wanted to engage or consult with a fiduciary duty to the claimant, the response was, take the structure that we offer or take cash.

These were hardball tactics designed to keep control of the structured settlement process for the defendants and their insurers. Loss of control meant loss of money saving tool -- of the money saving tool for the defense, and in some cases it also meant the loss of profitable annuity business for insurance groups that had life insurance affiliates, because the liability insurer could control where significant amount of settlement dollars were spent. The National Association of Insurance Commissioners calls this practice steering and describes it as an inappropriate solicitation activity.

Loss of control of the structured settlement transaction also meant the loss of sales commissions paid by the life insurance companies to life insurance agents who like to call themselves brokers as a reward for their efforts on behalf of the defendants or the insurers.

When one thinks about it, the refusal by the defense to allow an injury victim the right to engage his or her own

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structured settlement specialist to handle the periodic payment arrangement is morally indefensible. After all, the claimant is the ultimate consumer of the annuity even though the tax considerations prevent actual ownership.

By the mid 1990's, the defense canard that knowledge of an annuities cost causes constructive receipt have been revealed to the plaintiff's bar is untrue, and the amount of the proposed annuity premium to be spent by the defense then became integral to the settlement negotiations. The mediation paradigm had shifted from, "we offer you a cash lump sum and periodic payments as described in this proposal", to "let's settle on the total cost to the defense of settlement and then we'll decide how much will be spent on periodic payments."

With that paradigm shift, the commission for the annuity sale, which was bundled into the annuity premium, was now part of the gross settlement amount offered by the defense. Then the issue became which side had the right to pay a structured settlement specialist using the built-in commission.

Claimants began to assert that commission was part of the settlement offer, and therefore, they were entitled to engage the services of a structured settlement specialist loyal to them and to use the commission as compensation.

This notion upset the structured settlement agencies when they were in total control of structured settlements, and the battle over who gets the commission still rages today. The National Structured Settlements Trade Association, or NSSTA, fears the use of the qualified settlement fund because it gives the plaintiffs the opportunity of the structure without involvement of the defense. As early as 1997, NSSTA began to discourage the use of the CSF except in mass torts. It turned to its text counsel, the law firm of Hogan and Hartson, who came up with the theory that a qualified settlement fund created for a single claimant resulted in that claimant having the economic benefit and the funds.

In more than one instance, Hogan and Hartson claims that some officials at the Service, in this building, agree with their theory of economic benefit attaching when there is a single claimant. And details of that effort appear in my Virginia tax review article which is cited in my written comments, and I do have a hard copy of that that I can provide for the record, beginning at page 673.

So the economic benefit theory promulgated by the defense is the new canard to replace the old one. Remember, knowledge of the cost of the annuity is constructive receipt.

Well, the irony here is that NSSTA's stated mission is to promote the use of structured settlement, but in this case it was looking for a way to stop them from being arranged without the defense participation. They were, and still are, in effect, discouraging the use of structured settlements rather than promoting them. As soon as NSSTA discovered the request to Treasury in June of 2003, submitted by three distinguished alumni of the Internal Revenue Service, the request for published guidance on the single claimant issue, NSSTA wrote a letter urging that the guidance not be published. They did not advance any liable tax theory as to why a single claimant should be deemed or have economic benefit. They simply didn't want the guidance to be published, and that seems to be their mantra, just don't publish the guidance.

I note that John Stanton of Hogan and Hartson has submitted written comments for this hearing and is scheduled to appear right after me on behalf of NSSTA, and I believe he has submitted the 2003 NSSTA letter for the record of these proceedings. This is simply another way of saying don't publish the guidance.

His stated purpose, I understand, of being here today is to refute my suggestion, that the economic benefit issue be resolved -- can be resolved easily in the proposed revision, *Section 1.104 of the regulations,* on the basis that my suggestion exceeds the scope of the proposed revision. Of course, the scope should be whatever is needful, using a word from the statute, in order to clarify Code *Section 104.* I suppose I should be flattered that NSSTA used me as a threat to disrupting the status quo, and I hope that speaks for the credibility of my remarks today.

Now, let's get to the tax issues. I understand that branch four has limited the scope of the proposed revision to a couple

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issues in order to avoid the type of controversy that has stalled this project in the past. But the scope of this project should be determined by the necessity for guidance related to the tax code, *Section 104*, and not limited for the convenience of staff.

This issue is primarily a Code *Section 104* issue, and the corresponding regulation is an appropriate place to clarify how the code will be interpreted. I sincerely hope you'll recognize the legitimate need to clarify and that the law requires such clarification, and I refer to *Section 7805D* of the code.

There's simply a duty to the taxpayer constituency, a statutory duty of that to provide the guidance. This need is compounded by the fact that certain people within this building reportedly have made comments being used by the defense community to promote fear among those who would otherwise employ the qualified settlement fund for the benefit of their clients. I'm not asking the Service to develop a new policy to clarify this issue. I submit that the policy is already in existence, except that one must go to several different sources to piece it together.

The proposed scope of the regulation, of the revision rather is to incorporate some legislative history dating back to 1996, that's 14 years ago. What about the legislative history from 1982 that never got included in the regulations? That's 28 years ago, twice as long.

I elaborated in my earlier written submission on the policy that already exists, and I won't repeat it here for the record.

So I urge this panel to consider the writings of Jeremy Babner, who submitted his article on the single claimant issue for the record. The point here is that all these events I've described above and in detail in my previous submission, as well as in my Virginia tax review article, demonstrate that Congress, Treasury, including the IRS, and the courts have spoken on the single claimant issue, confirming that economic benefit does not attach in periodic payment arrangements. The rule is still from all of these events to be appropriately inserted into the corresponding regulations for Code *Section 104*. I previously provided proposed text, one single paragraph, for your consideration. Is that it? That's it, okay. All I can say is, please don't forget, you're here to serve the people, not the other way around. Thank you.

MR. MONTEMURRO: Very good.

MS. CRISALLI: I have a couple questions. If the defendants have so much leverage that they can say, take this structured settlement or you get a lump sum, why don't they have leverage to say if you don't use a QSF, we offer X, but if you use a QSF, it's X minus Y?

MR. RISK: I've heard that, I've heard that that's employed.

MS. CRISALLI: So in that case, you know, if the plaintiff has enough leverage to counter that, wouldn't they have enough leverage to counter without using a QSF?

MR. RISK: I'm not quite sure I'm following you, and maybe I'm not the right person to try to answer that.

MS. CRISALLI: Well, you're suggesting that without a QSF, the defendant can impose its will in terms of the settlement --

MR. RISK: That's true.

MS. CRISALLI: -- and I'm saying that even with a QSF, if the defendant had that much -- I'm asking, I'm suggesting, I don't know, if the defendant had that much power, perhaps they could also --

MR. RISK: I used to be in that position.

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MS. CRISALLI: -- undermine the use of a QSF?

MR. RISK: I used to be in that position. I would show up at mediations, and the defense person would literally scoff at me and say why are you here, this is my case, I am representing insurance company X, this is my case, you're going to go home with nothing, and at some point in the span of time, it was figured out that we could use the qualified settlement fund to replace that defendant. After all, the only thing the insurance company really should want is the release and the dismissal from the action, and so they could get that, they could get your tax deduction by the QSF, and that's an incentive.

And the courts will recognize this, too. The courts will recognize that if you create a qualified settlement fund and say to the court this is simply an entity to receive the settlement proceeds and give the plaintiffs then the time to make some informed financial decisions that they would otherwise be pressured into making at the time of the mediation. The defendant is out of the picture, and it would be a beneficial interest if they still wanted to impose their will and direct where the annuity goes. So I'm not sure that the carrot on the stick, so to speak, will give you a higher amount. I haven't really used it -- heard it used in that context, I've heard it used in -- you need to structure, and if you structure with us, we'll give you so much money, and if you don't structure, it'll be a cash lump sum of a lesser amount, which seems to suggest that there is a profit motive for the defendant.

MS. CRISALLI: Let me ask you the question I asked the last speaker, although I'll rephrase it. How do you think we could include a rule like this in a final reg under the APA without having proposed it first, a rule such as you suggest in your written comments?

MR. RISK: I'm not sure, I mean I don't understand the workings of the process as well as you do, but I assume that there's an opportunity for you to restate your proposal.

MS. CRISALLI: Well, we could repropose, yes, and then that would delay the effectiveness of the other rules that we have in there.

MR. RISK: Excuse me, but we're now 14 years into this.

MS. CRISALLI: Well, I understand.

MR. RISK: And maybe 28 years.

MS. CRISALLI: I understand.

MR. RISK: Okay. So time may be of the essence, but an additional six months.

MS. CRISALLI: Well, another possibility you might consider is suggesting, when it comes time to make comments on projects for the new business plan, that this be resurrected as a separate project, which would then allow us to propose something if it went out in a reg without delaying the other reg.

MR. RISK: Would it be appropriate to ask why it was terminated or removed from the plan after four and a half years?

MS. CRISALLI: You could ask that, but we won't answer.

MR. RISK: Okay. And I guess my response would be --

MS. CRISALLI: And nobody is supposed to know anything about that. So all these rumors you hear, you know, aren't

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worth the paper they're not written on.

MR. RISK: Well, it's not on the plan. I guess my immediate reaction was that because of this project, that you were going to include the guidance and that's why it was removed from the "to do" list.

MS. CRISALLI: Okay. Well, obviously that wasn't the case.

MR. RISK: Okay.

MS. CRISALLI: So if you think that this warrants our attention, you might consider, when the notice goes out around April'ish timeframe, soliciting ideas from the public, submitting a letter suggesting that we resurrect it.

MR. RISK: Would the same consideration then apply, because there's some darn good recommendations here regarding the definition of physical injury --

MS. CRISALLI: Absolutely.

MR. RISK: -- and that's beyond the scope of your proposal.

MS. CRISALLI: Absolutely.

MR. RISK: So I guess what -- if I understand you correctly that -- you're saying we're going to go ahead with the proposal that we've made and then it would be a whole new ballgame then if we considered other things?

MS. CRISALLI: I'm not saying anything.

MR. RISK: Okay.

MS. CRISALLI: But I am saying that one possibility would be to finalize the reg without these new proposals and address them in a separate guidance project rather than hold everything up to repropose. In other words, there's no reason why your proposal or the proposal without defining physical injury has to be attached to this project; it could be a separate project.

MR. RISK: Okay. I would agree with that. I have a little familiarity with the way the bureaucracy works. I was in the -- I was an Air Force officer, a squadron commander and a staff officer and a general's aide for several years, and I also ran a federal agency, and I do know that there are sensitivities of stepping into somebody else's bailiwick and whatever, and I thought that maybe because this had been at Treasury for four and a half years, that maybe it was untouchable.

MS. CRISALLI: I don't think that there is any -- that it would be any easier to get us to revisit this issue by attaching it to this project than by creating a new project. I don't, you know, the issue is going to be what are the other priorities on the business plan, do we have the resources, you know, is this of significant importance or more important than other projects that are vying for attention, and that would be the case whether we repropose these regs and wrap it into that or do another project. So you have to convince us that this is of more importance than other projects, that's the key.

MR. RISK: I've done my very best.

MR. MONTEMURRO: I guess we're done.

MS. CRISALLI: Thank you.

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MR. MONTEMURRO: The next speaker.

MR. ISKOW: The next speaker is John Stanton of the National Structured Settlements Trade Association.

MR. STANTON: Good morning. I'm John Stanton, I'm a partner with the Washington law firm of Hogan and Hartson. I represent the National Structured Settlement Trade Association and I'm here to continue the discussion about the dogs that didn't bark, but --

MR. MONTEMURRO: Maybe raise your voice a bit, a little louder.

MR. STANTON: On behalf of the Association, we would like a chance to respond. Some structured settlements have been invoked here. By way of background, the National Structured Settlement Trade Association, NSSTA, is the trade association of the structured settlement industry. It represents the entire industry, ranging from the plaintiff and defense brokers who work with the parties at the settlement table to develop, negotiate and implement the structured settlement, the life insurance companies who, under the congressional tax rules, create structured settlements, fund the structured settlements by way of annuities, the casualty companies that use structured settlements, participate in structured settlements to resolve their liability claims, plaintiff attorneys, defense attorneys, those that are active in the field.

You've got some important issues to address in this project, but our view is that structured settlements is not one of them. As you know, the project does not address structured settlements, and we see no reason to do so.

The suggestion has been made that the project be used as an opportunity to address this issue of a trust report to be created under *Section 468B* to -- for the benefit of a -- claim entered to a structured settlement. That issue is not addressed in the proposed regulations, it's beyond the scope of the proposed regulations, and we see no reason to address that issue by way of the vehicle of the project before you particularly since, as was noted, the guidance project regarding the single claimant, 468B, was dropped from the priority guidance plan.

Let me just say by way of background that structured settlements have been around for about 30 years and they work quite well. The structured settlement tax rules that were adopted by Congress in 1982 lay out a bright line path that's been followed in hundreds of thousands of structured settlements by claimants.

Structured settlements in which both sides today are represented by their own brokers, their own lawyers. Structured settlements enjoy broad support among the plaintiffs, by the defense, by the claims community, judges, mediators, the federal government.

The federal government engages in structured settlements quite lively to resolve federal -- cases, vaccine compensation cases, military hospitals. We see no reason to use the vehicle -- the project before you to reopen the structured settlement tax rules that have worked quite well over time. So, with that, I'd be pleased to answer any questions that you may have. I appreciate the opportunity to appear today.

MS. CRISALLI: Nope.

MR. MONTEMURRO: Okay, very good.

MR. STANTON: Thank you.

MR. ISKOW: Thank you.

MR. MONTEMURRO: That completes the list of scheduled speakers. So I'm just going to open up the floor. If anybody else wants to speak, raise your hand and come on down, introduce yourself and whether you're speaking on behalf of

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yourself or an organization. You had your hand up first, so you go first.

MR. MILLIGAN: Thank you for this opportunity to be heard. My name is Jack Milligan, I live in Portland, Oregon, I am a cofounder and co-President of Settlement Professionals, Incorporated, a 23 office nationwide firm that specializes in settlement planning directly with and on behalf of the personal injury victim.

I have been actively involved in the structured settlement and settlement planning industry for 25 years. I am a founder of the Society of Settlement Planners, SSP, and served as that organization's first president for its first three years.

I am a former member of NSSTA, the National Structured Settlement Trade Association. The SSP's members take an oath of loyalty to personal injury claimants and devote 100 percent of their practices and efforts to assisting these unfortunate victims to plan their settlements and their entire financial futures. The SSP is a professional trade association as opposed to being an industry trade association. The SSP does not have voting membership categories for annuity life insurance companies, for casualty insurance companies, for personal injury plaintiff or defense attorneys, or claim adjustors. Only our professional practitioner members are allowed to vote or hold office.

The SSP Mission Statement is to promote and preserve the rights of personal injury claimants to choose their advisors and product providers as they plan their personal injury settlements.

I am here today representing the SSP, in support of the effort to make the much-needed changes to *Section 104A*, as expressed by Mr. McCulloch in his comments, and also by Mr. Higgins in his written comments to this panel, and to support Attorney Richard Risk's suggestion that this effort include simple language that will positively assure personal injury victims that the doctrine of economic benefit will not apply to a qualified assignment emanating from a single claimant, QSF. I am also here to refute certain statements made by Mr. Joseph Ricci, the Executive Director of NSSTA, in his letter to this panel, and also just now by Mr. Stanton. In his letter, and in Mr. Stanton's comments, both assert that the insurance industry organization, NSSTA, represents all professionals in the structured settlements industry, both defense and plaintiff, and that all are opposed to Mr. Risk's suggestion, this is -- false.

NSSTA does not represent me, nor the merely 50 members of the SSP which includes both financial as well as legal settlement planners from around the country, all of whom have a stake in *Section 104* on a daily basis, and all of whom join me in urging this Committee to consider Mr. Risk's suggestion including guidance.

Mr. Ricci also states that issuing positive guidance would have a detrimental effect on the usage of structured settlements. Mr. Ricci cites no authority or study for this position, and indeed, NSSTA's own data would seem to support an entirely different position, in conclusion.

NSSTA's annual measurement of the growth of the industry seems to coincide with the proliferation in QSFs as the structured settlement industry has seen premiums grow from approximately four billion in the mid '90s to over six billion in the year 2008. Now, admittedly, some of this growth can be attributed to inflation in the general economy as well as inflation in medical expenses for our injury victims.

However, over this same timeframe, we have seen a proliferation of QSF's, Qualified Settlement Funds. In my office, I have been involved in over 200. My associates and peers have been involved in many hundreds more. One would think that with this dramatic increase in the usage of QSF's, that the utilization of structured settlements would have dropped if Mr. Ricci is to be believed. To the contrary, their utilization has increased. Why is this?

I'd like to give a brief history of this industry as I have seen it. In 1985, when I entered nearly complete control of this industry, it was through the defense side. They selected their brokers, they dictated the annuity companies and trust companies that the plaintiff would use. Plaintiff specialists like myself were denied access to the annuity markets by life insurance companies. Defendants, in essence, held 104A captive; as Mr. Risk described it, the carrot at the end of the

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stick. The plaintiffs could not give the benefits of 104 unless they accepted defense's choices of not only their brokers but the annuity companies, where they wanted the business to go. Also, most cases, no matter how large, were funded with a single annuity from one just -- from just one life insurance company. The plaintiffs at the time, many plaintiffs rejected structured settlements simply because they couldn't choose their own expert and they ultimately couldn't choose the companies that would be responsible to them. And they couldn't, in many cases, buy the fact that the people who caused their injuries would somehow profit from the settlement of their claim, and they could do nothing about that.

In 1988 through 1990, the Wild lawsuit occurred, and this, in essence, resulted in life insurance company appointments for people who worked on the plaintiff's side of the business. Up until that time, we couldn't even get access to the annuity markets with which to help these injury victims that we represented, a landmark situation for us.

In 1991, Executive Life of California went through a solvency crisis and entered conservatorship. First time in history that some personal injury victims suffer a partial loss of payment due to this insolvency. Diversification of annuity company risk becomes imperative from this time forward and plaintiffs begin to look for their own experts. 1992, regs regarding QSF's were issued; '96, the industry recognizes that QSF's have game changing potential as personal injury victims and no longer have to be subject to the disclosed or undisclosed financial agendas of the people who caused their injuries.

Defendants have sought to make all the choices for plaintiffs without remaining accountable or reliable for those choices. Instead, we see exactly what they were entitled to, a full, complete and irrevocable release from liability, nothing else.

Personal injury victims could now choose their own advisors and then select the companies. The annuity issuers and the trust companies would ultimately be responsible to them for their future payments. And they could diversify the risks in these transactions by selecting two or more companies as their guarantors.

2001, SSP is formed. Why? Because the NSSTA did everything in its power to marginalize those of us who work for plaintiffs, and NSSTA was perceived to be working against the rights of plaintiffs to choose who they wanted to work with. Also, the organization had become dominated by insurance companies, whose agendas included controlling commission flow from annuity policies so that portions of those commissions could be captured as profits. Also, the term "asset retention" became very popular at this time as insurance companies sought to capture claim dollars and transfer them to wholly owned insurance company annuity issuer affiliates. SSP believed that 104A2 was meant to benefit injury victims, not the --

2002, the use of QSF's explodes. NSSTA members pushed back, claiming that one or more language does not mean "one or more", and that economic benefit doctrine would apply. 2003, SSP submits request to Treasury for published guidance. IRS adds it to their business plan, 2004.

2008, financial meltdown. AIG and Hartford, big structured settlement annuity providers, both are in the forefront.

Interestingly, these two companies, along with the Department of Justice, are the two biggest or the three biggest perpetrators of forcing plaintiffs to follow their agenda and follow their will in where they want the settlement and claim dollars to go, with DOJ even denying claimants the right to have their own expert and to have that expert compensated out of the transaction that ultimately settled their case. So now here we are, and I on behalf of future personal injury victims, and the professionals that work with them, both financial and legal planners across the country, respectively ask you to consider adding positive guidance to 104A regarding single claimant QSF's: that economic benefit does not apply to disqualify a qualified assignment.

MS. CRISALLI: Do you think that plaintiffs really have no power to push back on defendants in terms of how they -- where they go for the structured settlement without using a QSF?

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MR. MILLIGAN: Prior to --

MS. CRISALLI: I mean do they have people like you to support them and advocate for them?

MR. MILLIGAN: -- prior to the creation of Qualified Settlement Funds in 468 cap B, it was extremely difficult. The personal injury victim had to have an exceptionally strong legal advocate to gain any traction at all.

MS. CRISALLI: Well, how about now?

MR. MILLIGAN: Now we have the QSF.

MS. CRISALLI: Without the QSF, if you don't use a QSF.

MR. MILLIGAN: Well, that's like saying let's roll the ball back up the hill and imagine what the situation would be. If we didn't have QSF's, I imagine it would be the same as it was prior. But now, because of their existence, we can't really put that genie back in the bottle, and what has happened is that the mere fact that QSF's are available is enough to persuade many times the defense side of these cases that they should try to acquiesce to the plaintiff's demand.

MS. CRISALLI: Well, that's my point exactly.

MR. MILLIGAN: Okay.

MS. CRISALLI: Is it the mere threat of the QSF helpful?

MR. MILLIGAN: It is, except in the case where we now have companies and the Department of Justice who are, as part of the negotiations, telling the plaintiff, if you think you're going to use a Qualified Settlement Fund, think again, we will oppose it, it's a risky tax transaction, it's not proven, we believe economic benefit would apply, and the tax consequences would also come back to us on the defense side.

MS. CRISALLI: I assume then that plaintiffs that use QSF's are applying the 104A2 exclusion?

MR. MILLIGAN: Yes.

MS. CRISALLI: They're not treating it as taxable?

MR. MILLIGAN: Yes, that's true.

MS. CRISALLI: Okay.

MR. MILLIGAN: And single claimant QSF's are being used around the country for those brave enough to step out and say, my advisors have told me, explained what the code says, that these can be used for one or more claims, and I'm going to believe that the code says what it says.

MS. CRISALLI: Thank you.

MR. MONTEMURRO: Okay. Is there anybody else who would like to speak?

MR. LEYDEN: Good morning, Mr. Chairman, ma'am. I am Edward Leyden, I'm here -- I'm a partner at the law firm Hallwell Leyden, but I'm here today in my capacity as President of Consumers for Civil Justice. At Consumers for Civil

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Justice, there's a *Section 501C6* trade association comprised of attorneys here in the metropolitan Washington, D.C., area who fight for the rights of people that have suffered harm from discrimination and from the wrongful acts and omissions of others, in short, the plaintiff spot, as we've heard described. We view the tax policies underlying *Section 104A2* to be both wise and well founded because the financial compensation that one may receive in a court of law or as the result of a legal settlement for physical harm and pain is certainly not an accretion of wealth by any measure. It is, thus, entirely fair and proper that such sums be statutorily excluded from income and not subject to taxation.

CCJ further applauds the clarification that the Service is linked to *Section 104A2* and that that -- since 1996, when Congress substantially modified the statute, and especially the thought and insight that went into the proposed regulations that are the subject of this hearing today.

However, we do echo the concerns expressed by Stuart Lewis in the American Bar Association section of taxation concerning the need to clarify that compensation, for physical injuries and sickness comes within the ambit of Section 104A2, even if such harm resulted from a wrongful act that did not encompass physical contact or touching. Such qualification will be manifestly continent with the policy considerations underlying these proposed regulations and of a whole with the thoughtfulness and compassion that ultimately animates them. In the interest of full disclosure, I should point out that while I'm a currently serving officer of the ABA Section of taxation, at which I share the Committee for Employment Taxes, that's not the capacity that I'm here today, and I had no part in writing or preparing the comments that the ABA tax section itself submitted.

I thank you for this opportunity to testify on behalf of our Association, and, of course, would be delighted to answer any questions that I may.

MR. MONTEMURRO: Fine.

MR. LEYDEN: Thank you.

MR. MONTEMURRO: Very good. Okay. Is there anybody else who would like to speak this morning? Okay. Then I thank you all for coming this morning and setting forth your views, and we'll be working here on the regulations and trying to move them toward the final product, and I think you all for coming, and the hearing is adjourned.

(Whereupon, at 11:08 a.m., the HEARING was adjourned.)

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OCTOBER 07, 2009, WEDNESDAY

DEPARTMENT: Public Comments on Regulations

CITE: *2009 TNT 192-21*

LENGTH: 5711 words

HEADLINE: 2009 TNT 192-21 ATTORNEY SUGGESTS CHANGES TO PROPOSED REGS ON EXCLUSION OF PHYSICAL INJURY OR SICKNESS DAMAGES. (Section 104 -- Damage Awards/Sick Pay) (Release Date: OCTOBER 01, 2009) (Doc 2009-21897)

CODE: *Section 104* -- Damage Awards/Sick Pay;
Section 130 -- Personal Injury Liability Assignments;
Section 451 -- Year of Inclusion;
Section 468B -- Designated Settlement Funds

ABSTRACT: Richard B. Risk Jr. of the Risk Law Firm, in comments on proposed regulations on the removal of the requirement that personal injury damages be based on tort or tort-type rights, has asked the IRS to publish rules on the application of the economic benefit doctrine to amounts received to resolve claims.

SUMMARY: Published by Tax Analysts(R)

Richard B. Risk Jr. of the Risk Law Firm, Tulsa, Okla., in comments on proposed regulations (REG-127270-06) on the removal of the requirement that personal injury damages be based on tort or tort-type rights, has asked the IRS to publish rules on the application of the economic benefit doctrine to amounts received to resolve claims and has suggested various changes for incorporation into *reg. section 1.104.*

AUTHOR: Risk, Richard B.
Risk Law Firm

GEOGRAPHIC: United States

REFERENCES: Subject Area:
Individual income taxation

Cross Reference:
For REG-127270-06, see *Doc 2009-20411* or *2009 TNT 176-6.*

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Release Date: OCTOBER 01, 2009

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From: Dick Risk [Mailto:dick@risklawfirm.com]
Sent: Thursday, October 01, 2009 2:01 PM
To: Hurst Richard A
Cc: Iskow Sheldon A
Subject: Proposed Rules DOCID: fr15se09-26 FR Doc E9-22221

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Subject: Proposed Rules DOCID: fr15se09-26, FR Doc E9-22221, 26 CFR Part 1, Para. 2, Sec. 1.104-1(c), Compensation for injuries or sickness

"[T]he Secretary of the Treasury shall prescribe all needful rules and regulations for the enforcement of this title [Title 26, U.S. Code]." -- I.R. C. section 7805(d)

The Service has issued proposed Income Tax Regulations that would amend section 1.104-1(c), "Compensation for injuries or sickness," very narrowly to reflect amendments under the Small Business Job Protection Act of 1996 and to delete the requirement that, to qualify for exclusion from gross income, damages received from a legal suit, action, or settlement agreement must be based upon "tort or tort type rights." The Service would be remiss in fulfilling its duty, on behalf of the Secretary of the Treasury, to "prescribe all needful rules and regulations for the enforcement of the Internal Revenue Code, for this section of the regulations has always lacked the inclusion of important legislative history, dating to the Periodic Payment Settlement Act of 1982. It is the intent of Congress that the setting aside of funds in trust for a recipient to produce periodic payments, which generally confers an economic benefit and results in income to the recipient in the year of setting aside the funds, is allowed without regard to whether the recipient has the current economic benefit or constructive receipt of the sum required to produce the periodic payments, and any amount received pursuant to the exclusion prescribed in *section 104(a)(2)* will not be included in the recipient's gross income.

This issue encompasses at least Code *sections 104*, 130, 451 and 468B, and perhaps 83. It has been identified by Treasury and the Service in a narrow form and first appeared on the Office of Tax Policy and Internal Revenue Service 2004-2005 Priority Guidance Plan under the heading, Tax Accounting, as "Guidance under *section 468B* regarding the tax treatment of a single-claimant qualified settlement fund." This can just as well be classified as a *section 104* issue, as *sections 130*, 451 and 468B are inextricably linked to each other. With the insertion of a single subparagraph in *regulations section 1.104-1(c)* that is consistent with clear congressional guidance and with previous rulings of the Service, this important issue is resolved, not just for designated settlement funds and qualified settlement funds derived from *section 468B*, but for any entity where damages have been deposited to resolve or satisfy claims when current year recognition of the payments is meant to be avoided, including but not necessarily limited to the entities that assume a periodic payment obligation under a *section 130* "qualified assignment."

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Recommendation:

I recommend the inclusion of the following text after subparagraph (2), as separate subparagraph (3), and that the currently proposed subparagraph (3) is renumbered as (4):

(3) Amounts received as damages into a fund, account, or trust that is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability do not result in income to the intended recipient in the year of setting aside the funds without regard to whether the recipient has the current economic benefit or constructive receipt, as defined in regulations section 1.451-2(a), of the sum required to produce the periodic payments or that may be distributed from the fund, account or trust in a subsequent year. The fund, account or trust must be a trust under applicable state law, or its assets must be otherwise segregated from other assets of the transferor (and related persons). This applies to amounts received under a "qualified assignment" of a periodic payment obligation pursuant to Code *section 130(c)* or by a designated settlement fund or qualified settlement fund established pursuant to Code *section 468B* and/or Income Tax *Regulations section 1.468B-1(c)*, but without limitation to these two types of entities. Payments that qualify for exclusion from the recipient's gross income under Code *section 104(a)(2)* will still qualify for exclusion without regard to whether the recipient had economic benefit or constructive receipt of the amount prior to its distribution, whether paid from an obligor of a *section 130(c)* "qualified assignment," from a *section 468B* entity, or in any other fashion. Recognition of payments that do not qualify for the *section 104(a)(2)* exclusion similarly can be deferred until the years in which the distributions are made, without regard to whether the recipient has had economic benefit or constructive receipt of the amounts while held by the fund, account or trust.

The Document Summary in the announcement would need to be expanded to incorporate this additional guidance.

Background and Explanation:

The Periodic Payment Settlement Act of 1982 added *section 130* and amended *section 104(a)(2)* to exclude personal injury damages received as periodic payments from the recipient's gross income, whether by suit or agreement. Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, *section 104(a), 96 Stat. 2605, 2605 (1983)* (codified at *I.R.C.*

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section 130). The new provision of *section 104(a)(2)* was intended to codify existing law as reflected in Revenue Rulings 77-230, 79-220 and 79-313. *See Rev. Rul. 77-230, 1977-2 C.B. 214; Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.)*

Congress created an exception to the broad rule established by case law defining economic benefit as applied to structured settlements. H.R. REP. NO. 97-832, pt. II, at n.2 & Explanation of Provisions (1982). *Revenue Ruling 79-220* was one of three key rulings that were later codified by the Periodic Payment Settlement Tax Act of 1982. The facts of that ruling were as follows:

> [T]here is a continuing obligation by *M* to $ 250 per month to *A* for the agreed period. *M*'s purchase of a single premium annuity contract from the other insurance company was merely an investment by M to provide a source of funds for M to satisfy its obligation to *A*. See *Rev. Rul 72-25, 1972-1 C.B. 127,* which relates to a similar arrangement made by an employer to provide for payment of deferred compensation to an employee. In *Rev. Rul. 72-25,* as here, the arrangement was merely a matter of convenience to the obligor and did not give the recipient any right in the annuity itself. *Rev. Rul. 79-220, 1979-2 C.B. 74.*

On these facts, the Service held:

> The exclusion from gross income provided by section *104(a)(2) of the [Internal Revenue Code* of 1954] applies to the full amount of the monthly payments received by *A* in settlement of the damage suit because *A had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump-sum that was invested to yield that monthly payment* (emphasis added). If *A* should die before the end of 20 years, the payments made to A's estate under the settlement agreement are also excludable from income under section 104.

Under the facts of *Revenue Ruling 79-220,* the single premium immediate annuity purchased by *M* as a convenience to *M* to fund its obligation to *A* is an amount set aside irrevocably for *A*'s sole benefit. Economic benefit applies, according to *Sproull,* when assets are unconditionally and irrevocably paid into a fund or trust to be used for a taxpayer's sole benefit. *Sproull v. Commissioner, 16 T.C. 244, 247-48 (1951).* However, as in *Sproull,* the deciding factor in *Revenue Ruling 79-220* was control. Sproull alone had an interest in or control over the monies in the trust and was therefore required to take no further action to earn or establish his rights to the amounts in trust. *A,* in contrast, had a right to receive only the monthly payments and thus had no right or control over the annuity. *A* was a single claimant.

In the House of Representatives Report accompanying the Periodic Payment Settlement Tax Act of 1982, the Committee on Ways and Means summarized the present law pertinent to this issue in its "Explanation of the Bill," as follows:

> *Rev. Rul. 79-220* holds that where the insurer of

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> a tortfeasor purchases and retains exclusive ownership of a single-premium annuity contract to fund specified monthly payments for a fixed period pursuant to settlement of a damage suit for personal injuries, the recipient may exclude from his or her gross income the full amount of the payments, and not merely the discounted present value. *The taxpayer's only right with respect to the amount invested was to receive the monthly payments, and the ruling concluded that the taxpayer did not have actual or constructive receipt or economic benefit of the amount invested.* H.R. REP. NO. 97-832, pt. II, at n.2 (1982) (emphasis added).

The same report, under reasons for change, clarified that Congress was accepting the Service's decision on the underlying facts of *Revenue Ruling 79-220.* It agreed with the Service that neither actual or constructive receipt nor economic benefit of the amount invested was triggered. The Report explained that

> [t]he bill specifically provides that the Code *section 104* exclusion from gross income of damages for personal injuries or sickness applies whether the damages are paid as lump sums or as periodic payments. *This provision is intended to codify, rather than change, present law.* Thus, the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments. *Id.* at pt. II (emphasis added). The pertinent text is identical in the Senate version of the report to accompany H.R. 5470. S. REP. NO. 97-646, at 4 (1982)

Thus, Congress expressed its intent that, in structured settlements, the judicial doctrine of economic benefit does not apply simply because a sum is set aside irrevocably for the payee's sole benefit -- even if the payee is the only claimant who will benefit from the sum set aside. Certainly, Congress intended a bright line distinction in that economic benefit attaches only when the claimant is given control over the sum. Now that Congress has spoken on the issue by adopting the Service's interpretation as its own, neither Treasury nor the Service may override it. It is highly appropriate that the Service now -- some 27 years since the enactment of the Periodic Payment Settlement Tax Act of 1982 -- should acknowledge that its original interpretation has been memorialized in the legislative intent of the Tax Code by including it in the Income Tax Regulations.

Congress has shown that it did not intend the judicial doctrine of economic benefit to apply to a designated settlement fund (DSF) or qualified settlement fund (QSF) created for the benefit of a single claimant. The single claimant would not have access to the amount transferred into the DSF/QSF because it is: (1) controlled by the DSF/QSF administrator, who is independent of the claimant; (2) subject to the continuing jurisdiction of a court or other governmental agency; and (3) not even dedicated to the claimant's benefit until a settlement agreement between the claimant and the DSF/QSF is executed. *Revenue Ruling 79-220* held that when funds or an asset (annuity) are held for the benefit of a claimant (a single claimant under those facts) to provide periodic payments, and the claimant has no control over those funds, the claimant does not have constructive receipt or economic benefit of those funds. Under the facts of *Revenue Ruling 79-220,* the claimant was entitled to receive periodic payments generated by the assets being held for the claimant's

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benefit. Where the assets are simply being held in the DSF/QSF, the claimant has no rights to future payments until a settlement agreement is executed. This creates additional distance between the funds and the claimant that did not exist in the facts of *Revenue Ruling 79-220,* strengthening the argument that there is no economic benefit.

Congress specifically agreed, through the legislative history of both the House and Senate for the Periodic Payment Settlement Tax Act of 1982, with the Service's interpretation and findings in *Revenue Ruling 79-220.* It accepted that neither constructive receipt nor economic benefit should apply when the single claimant had no control over the funds being held for his benefit. *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 976-473, *96 Stat. 2605 (1983)* (codified at *I.R.C. section 104(a)*); H.R. CONF. REP. NO. 97-984 (1982); H.R. REP. No. 97-832, pt. II, n.2 (1982); S. REP. 97-646, pt. II, n.2 (1982). Congress expressly stated that it was codifying the existing law. H.R. REP. NO. 97-832, pt. II, Explanation of Provisions (1982).

Congress has indicated through subsequent legislation, such as the Technical and Miscellaneous Revenue Act of 1988 and the Victims of Terrorism Tax Relief Act of 2001, that the economic benefit doctrine should not be expansively interpreted. The narrower definition of economic benefit provides the claimant some rights for the payee in the funding asset itself that *Sproull* and successive case law had not allowed previously in defining the broad rules of the economic benefit. *See Sproull v. Commissioner, 16 T.C. 244 (1951).*

Congress has softened its stand on the economic benefit doctrine and whether it renders a periodic payment obligation, excluded from the recipient's gross income under *section 104(a)(2)* unassignable under *section 130.* As initially enacted in 1982, *section 130* restricted the rights a claimant has against the assignee and in the assets used to fund future periodic payments. *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, *section 101, 96 Stat. 2605, 2605-2606 (1983)* (codified at *I.R.C. section 130*). Congress repealed *section 130(c)(2)(C)* in 1988 because, in Congress's view, "[r]ecipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of the tax law." H.R. REP. No. 100-795, at 541 (1988). *I.R.C. section 130(c)(2)(C)* (repealed 1988). Public Law 100-647, *section 6079(b)(1)(A),* deleted Code *section 130* subparagraph (c)(2)(C) and redesignated subparagraphs (c)(2)(D) and (c)(2)(E) as subparagraphs (c)(2)(C) and (c)(2)(D). Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, *section 6079(b)(1)(A), 102 Stat. 3342, 3710 (1988).* The deleted subsection read as follows: "(C) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor." *26 U.S.C.A section 130,* History, Ancillary Laws and Directives (1999).

Congress also provided much greater rights to payees in structured settlements with the enactment of the Victims of Terrorism Tax Relief Act of 2001, which added *section 5891 to the Code. See* Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, *115 Stat. 2427* (codified at *I.R.C. section 5891*). *Section 5891* regulates factoring transactions by imposing a forty percent federal tax on the factoring discount unless approved in advance by an applicable state court. *I.R.C. section 5891(a).* This section also gives payees the ability to transfer structured settlement payment rights (including portions of structured settlement payments) made for consideration by means of sale, assignment, pledge, or other form of encumbrance or alienation for consideration. *Id. section 5891(c)(3)(A).* These new rights go far beyond those of the payee in *Revenue Ruling 79-220.* Under that ruling, the payee could receive only the monthly payments -- he could not have the actual or constructive receipt or the economic benefit of the lump sum that was invested to yield that monthly payment.

The developments following the codification of *Revenue Ruling 79-220* in the Periodic Payment Settlement Tax Act of 1982 indicate that a more lenient interpretation of constructive receipt and economic benefit is appropriate for structured settlements. The definitions of constructive receipt and economic benefit are to be construed much more narrowly when applied to structured settlements than to other deferred compensation situations when congressional intent is considered.

The technical arguments of congressional intent are straightforward, gleaned from the statutes and their amendments as well as committee reports. Based on these sources, it is apparent that Congress did not intend for the judicial doctrine of

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economic benefit to apply to the facts of any entity that can assign periodic payment obligations, without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments, including but not necessarily limited to assignment from a designated settlement fund or qualified settlement fund created for the benefit of a single claimant.

Congress has expressly noted on these several occasions noted herein that economic benefit does not attach in structured settlement situations as easily as it might attach in other types of deferred compensation agreements. Court decisions in this area likewise suggest that a narrow interpretation of economic benefit is appropriate in the case of structured settlements. In *Childs v. Commissioner*, the Tax Court rejected the Service's position that the right of attorneys to receive periodic payments on behalf of their clients, in satisfaction of the clients' debt for attorney fees, was funded or secured. *103 T.C. 634 (1994), aff'd 89 F.3d 865 (11th Cir. 1996).*

The court held that the cost of the annuity contract funding the structured settlements received by the taxpayers in satisfaction of attorney's fees represented mere "unfunded promises," and did not constitute "property" under *section 83.* Therefore, it was not taxable in the year of purchase. The issue appealed by the Service to the Eleventh Circuit was whether the purchase price of the annuities constitutes "property" per Code *section 83* and, if so, whether that "property" was transferred. The circuit court rejected the Service's position and upheld the Tax Court ruling. *Childs v. Commissioner, 89 F.3d 865, 865 (11th Cir. 1996).*

Decisions by the courts also suggest a narrower definition of economic benefit in the case of structured settlements. The Tax Court's decision in *Childs*, as affirmed by the Eleventh Circuit, confirms that the economic benefit doctrine does not apply even to attorneys who collect all or part of their attorney fees in periodic payments from clients entitled to damages excluded under *section 104(a)(2). I.R.C. section 104(a) (2); Childs v. Commissioner, 103 T.C. 634 (1994), aff'd, 89 F.3d 856 (11th Cir. 1996).* Congressional action and the decision in *Childs* provide controlling authority that economic benefit does not attach to any payee in a structured settlement, so long as the payee has only the rights to the future payments and does not control the qualified funding asset. The claimant may, however, have a right to a security interest in the funding asset, and he may sell, assign, pledge, encumber by some other form, or alienate by consideration the future payments.

The basic economic doctrine remains intact if Treasury and the Service issue the written guidance requested on whether a QSF established for the benefit of a single claimant may make a qualified assignment within the meaning of *section 130.* This is a carve-out that provides exceptions to the broad rule. The difference between structured settlements and other garden-variety deferred compensation agreements is easily distinguishable.

Previous rulings by the Service that would be codified by this proposal:

The Service cited *Sproull* in *Revenue Ruling 2003-115,* issued as guidance for those opting for periodic payments from the September 11th Victim Compensation Fund of 2001. *Revenue Ruling 2003-115* provides the necessary guidance for a structured settlement with a QSF established for the benefit of a single claimant:

> The economic benefit doctrine, developed in case law, provides that if a promise to pay an amount is funded and secured by the payor, and the payee is not required to do anything other than wait for the payments, an economic benefit is considered to have been conferred on the payee and the amount of such benefit is considered to have been received. In *Sproull*, the court found that an economic benefit had been conferred on a taxpayer when the taxpayer's employer established a trust to compensate the taxpayer

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> for past services. In 1945, the employer transferred money to the trust to be paid to the taxpayer in 1946 and 1947. The taxpayer was the trust's sole beneficiary. The court held that the taxpayer received compensation in 1945 in an amount equal to the value of the amount transferred to the trust for the taxpayer's benefit because such transfer to the trust provided the taxpayer with an economic benefit.
>
> Not all rights to receive periodic payments, however, trigger application of the economic benefit doctrine. *Rev. Rul. 79-220, 1979-2 C.B. 74,* concludes that a right to receive certain periodic payments under the facts of the ruling does not confer an economic benefit on the recipient. In *Rev. Rul. 79-220,* a taxpayer entered into a settlement with an insurance company for the periodic payment of nontaxable damages for an agreed period. The taxpayer was given no immediate right to a lump sum amount and no control of the investment of the amount set aside to fund the insurance company's obligation. The insurance company funded its obligation with an annuity payable directly to the taxpayer. The insurance company, as owner of the annuity, had all rights to the annuity and the annuity was subject to the claims of the general creditors of the insurance company. The ruling concludes that all of the periodic payments are excluded from the taxpayer's gross income under *section 104(a)(2)* because the taxpayer did not receive, or have the economic benefit of, the lump sum amount used to fund the annuity. Further, the ruling holds that if the taxpayer dies before the end of the agreed period, the payments made to the taxpayer's estate under the settlement agreement are also excludable from the gross income of the estate under section 104(a)(2).

The issue in PLR 97-03038 was whether a trust may act as an assignee for purposes of *section 130 of the Code*:

> Under the facts presented, the assignee of the defendant's obligation to make periodic payments is T, a trust. T receives a lump sum from the defendant, from which it will make the periodic payments to the plaintiff. T uses the lump sum to purchase funding assets. T holds the funding assets in its name, grants the plaintiff a security interest in the funding assets, and uses the payout from the funding assets to fund the periodic payments.

On these facts, the Service ruled:

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> Generally, the setting aside of funds in trust for a recipient confers an economic benefit and results in income to the recipient in the year of setting aside the funds. See *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd per curiam., 194 F.2d 541* (6th Cir. 1952). However, the 1988 amendment to section *130(c) of the Code* was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments. Therefore, assuming all other requirements of section 130(c) are met, an assignment of liability to T as assignee will be treated as a qualified assignment under *section 130(c)*. Further, any amount received by T for agreeing to a qualified assignment will not be included in T's gross income to the extent such amount does not exceed the aggregate cost of any qualified funding assets as defined in section 130(d).

The Service also ruled previously, in PLR 97-36032, in favor of four taxpayers who were each sole beneficiaries of identical qualified settlement funds, declaring *"no inclusion in gross income will be required of the beneficiaries of the funds as a result of the transfer of settlement proceeds to funds."* Obviously, the Service found that economic benefit did not attach simply because the QSF was established for the benefit of a sole individual. There was no "qualified assignment" of periodic payments. In fact, there were no periodic payments, and the sums to be paid were to be taxed to the recipients in the years in which the payments are received.

In *PLR 200836019,* the Service recognized the concept of a "non-qualified assignment" and that such an arrangement can also defer current year recognition of the amounts received by a fund, account or trust not organized under the provisions of Code *section 130* or 468B. The Service said:

> Neither the execution of the Non-Qualified Assignment nor the purchase of an annuity contract by the Assignee to fund its obligation to the taxpayer shall be viewed as conferring a current economic benefit on the taxpayer. After the execution of the Non-Qualified assignment, the taxpayer will possess only a mere promise to be paid (although the identity of the promisor will have changed), Moreover, no amount will be set aside from which to make the scheduled payments, nor will a separate fund to irrevocably and unconditionally set aside for the benefit of the taxpayer. Furthermore, taxpayer has no rights against the Assignee other than that of a general creditor.
>
> Based on the above, neither the "constructive receipt" doctrine, the "cash equivalency" doctrine, nor the "economic benefit" doctrine shall apply to the taxpayer's acts regarding the Periodic Payments.

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Thus, the guidance proposed for inclusion in the revised *section 1.104 of the regulations* is not confined to funds, accounts or trusts organized under Code *section 130* or 468B, nor is it confined to amounts that will be paid under the exclusion from gross income provided by *section 104(a)(2)*. Consistent with previous rulings, recognition by the intended recipient(s) of the amounts received by the fund, account or trust may be deferred to the years in which the distributions are made.

It is conceded that a private ruling may not be used or cited as precedent, per Code *section 6110(k)(3)*, unless the Secretary of the Treasury establishes otherwise by regulations. However, the U.S. Supreme Court determined in *Hanover Bank v. Commissioner, 369 U.S. 672, 686-87 (1962)*, that private rulings issued by the Service reflect that agency's interpretation of the statute and, thus, may be used as evidence in litigation of tax matters. Previous rulings by the Service, including private letter rulings intended only for the requesting taxpayer, should be incorporated in published rules when necessary to provide "all needful rules and regulations," as required by Code *section 7805(d)*. Previous rulings on the issue of economic benefit and constructive receipt of damage amounts held in a fund, account or trust for later distribution should be codified. This proposed revision to *section 1.104 of the Income Tax Regulations* offers a perfect and timely opportunity to do so.

As a practitioner who has been involved in periodic payment tax issues since 1986, I can attest to the need for published rules on the application of the economic benefit doctrine to amounts received to resolve claims. I urge Treasury and the Service to adopt the text I have proposed, and incorporate it into Income Tax *Regulations section 1.104*.

References:

23 Va. Tax. Rev. 639 (2004), Richard B. Risk, Jr., *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund for a Single Claimant.*

2008 TNT 30-19, Richard B. Risk, Jr., *Attorney Comments on Forthcoming Guidance on Use of Qualified Settlement Funds for Benefit of Single Claimant.*

Federal Register notice link: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?
c=ecfr&sid=e257b9bdbbc4eaec2e623d8018c0bcla&rgn=div8&view=text&node=26:2.0.1.1.1.0.4.10 9&i

Current Income Tax *Regulations section 1.104* link:

http://www.thefederalregister.com/d.p/2009-09-15-E9-22221

Request for a Public Hearing:

I respectfully request that a public hearing be held on this matter and that I be notified directly of its time and place, so that I have the opportunity to appear.

As a practitioner who has been involved in periodic payment tax issues since 1986, I can attest to the need for published rules on the application of the economic benefit doctrine to amounts received to resolve claims. I urge Treasury and the Service to adopt the text I have proposed, and incorporate it into Income Tax *Regulations section 1.104*. This is just as appropriate to be indexed with rules for Code *section 104* as it would be for *section 130*, 451 or 468B.

I submit this recommendation on my own behalf, not on behalf of anyone else or any organization to which I belong or am affiliated.

Respectfully submitted,

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REMARKS OF:
RICHARD B. RISK, JR., ESQ.
BEFORE THE INTERNAL REVENUE SERVICE
WASHINGTON, D.C.
PERTAINING TO PROPOSED REVISION OF 26 C.F.R. § 1.104
FEBRUARY 23, 2010, 10 A.M.

NOTE: TIME CONSTRAINTS PREVENTED THE ORAL DELIVERY OF THIS ENTIRE TEXT. SEVERAL PARAGRAPHS WERE NOT READ ALOUD. THESE PREPARED COMMENTS WERE HANDED TO THE REPORTER FOLLOWING THE HEARING, ALONG WITH MY *VIRGINIA TAX REVIEW* ARTICLE, CITED IN THESE REMARKS. FOLLOWING IS WHAT I WOULD HAVE READ IF GIVEN ADEQUATE TIME.

Mr. Chairman, ladies and gentlemen, thank you for the opportunity to appear at this hearing. My name is Richard B. Risk, Jr. I reside in both Tulsa, Oklahoma, and St. Petersburg, Florida. I am an attorney whose entire law practice focuses on the aspects of tort claim settlements. I have written documents to establish more than 250 qualified settlement funds and have administered the majority of them. I have been published extensively in legal journals and have chaired tax panels for a professional association, the Society of Settlement Planners, including guest panelists from Treasury and the Internal Revenue Service. I am appearing today on my own.

Structured settlements are a very important tool in the resolution or satisfaction of claims originally asserted by injury victims against the tortfeasors after the liability for such claims has been transferred by novation to the qualified settlement fund. I will get to the tax issues in a few minutes, but first I want to present a little background on the undercurrent within the structured settlement industry that may serve to explain why we may have differences of opinion among ourselves as to how the Tax Code should be interpreted.

I first came into the structured settlement community in 1986 as a producer and eventually joined the National Structured Settlements Trade Association because it was required of anyone who sought to be appointed by the major annuity markets. At the time I joined the trade association, the marketing orientation for structured settlements was almost entirely from the defense side. Structured settlement producers worked with corporate risk managers and liability insurance claim adjusters to propose periodic payments to injury victims, along with the attractive tax subsidy, as a way the responsible party could save money in settling claims.

If the claimant or claimant's attorney wanted to know the cost of the funding asset—the annuity—the response was that knowledge of the amount would cause the claimant to be in constructive receipt of the funding asset and, thus, would lose the tax benefits.

If the claimant felt uncomfortable allowing the structured settlement producer engaged by the defendant to handle perhaps the biggest financial transaction of the claimant's life, and wanted to engage a consultant with a fiduciary duty to the claimant, the response was "take the structure that we offer or take cash." These were hardball tactics designed to keep control of the structured settlement process for the defendants and their insurers. Loss of control meant loss of a money-saving tool for the defense and, in some cases, it also meant the loss of profitable annuity business for insurance groups that had life insurance affiliates, because the liability insurer could control where a significant amount of settlement dollars were spent. The National Association of Insurance Commissioners calls this practice "steering" and describes it as an "inappropriate solicitation activity."

Loss of control of the structured settlement transaction also meant the loss of sales commissions paid by the life insurance companies to life insurance agents who like to call themselves "brokers," as a reward for their efforts on behalf of the defendants or their insurers.

When one thinks about it, the refusal by the defense to allow an injury victim the right to engage his or her own structured settlement specialist to handle the periodic payment arrangement is morally indefensible. After all, the claimant was the ultimate consumer of the annuity, even though tax considerations prevent actual ownership.

By the mid-1990s, the defense canard that knowledge of an annuity's cost causes constructive receipt had been revealed to the plaintiff's bar as untrue, and the amount of the proposed annuity premium to be spent by the defense became integral to the settlement negotiations. The mediation paradigm had shifted from "we offer you a cash lump sum and periodic payments as described in this proposal" to "let's settle on the total cost to the defense of settlement, and then we'll decide how much will be spent on the periodic payments." With that paradigm shift, the commission for the annuity sale, which was bundled into the annuity premium was now part of the gross settlement amount offered by the defense. And, the issue became which side had the right to pay its structured settlement specialist using the built-in commission. Claimants began to assert that the commission was part of the settlement offer and, therefore, they were entitled to engage the services of a structured settlement specialist loyal to them and to use the commission as compensation. This notion upset the unconscionable marketing model built by the liability insurance claims departments and structured settlement agencies when they were in total control of structured settlements, and the battle over who gets the commission still rages today.

The Society of Settlement Planners was formed in 2001 to promote the rights of plaintiffs. In 2003, several members of the SSP risked losing their life insurance company appointments by resigning their memberships in NSSTA. It was obvious to them that NSSTA did not represent their interests and that the trade association was spending their dues on causes adverse to their interests. The life insurance markets evidently realized that this group of advocates for plaintiff rights represented a large block of annuity premium production, and did not terminate their appointments, apparently changing their former stance that those appointed to sell structured settlement annuities must be members of NSSTA.

One of the reasons for the success of these plaintiff-oriented structured settlement producers was the use of the qualified settlement fund. Plaintiff's lawyers who were concerned about their own exposure to legal malpractice claims by their own clients for allowing the defense to take control of their clients' financial future became enamored with the qualified settlement fund. They could give the defendants an immediate release and dismiss them from the litigation while preserving the opportunity for their clients to structure—without the pressures of quick decision making that usually occur at mediations, and without the involvement of the opposing side.

These resignations in 2003 by a number of successful structured settlement producers were also very significant because it meant, for the first time, NSSTA did not represent the entire structured settlement industry. NSSTA cannot seem to let go of its claim to represent the entire structured settlement community, as they arrogantly repeat that claim whenever they think somebody will listen. But, it is a blatant misrepresentation of their constituency.

The Society of Settlement Planners decided to demonstrate its independence from NSSTA in June 2003 when it asked Treasury to clarify the tax treatment of a section 130 qualified assignment of a periodic payment obligation when made by a qualified settlement fund that was established to settle with a single claimant. The request was signed by three distinguished alumni of the Service: Jody J. Brewster, former assistant chief counsel, Income Tax and Accounting; Kenneth W. Gideon, former chief counsel; and Fred T. Goldberg, former chief counsel and commissioner. Mr. Gideon and Mr. Goldberg both also served as assistant secretary of the Treasury for Tax Policy. All three are law partners at Skadden, Arps, Slate, Meagher & Flom, LLP.

I subsequently wrote an article published in the *Virginia Tax Review* (23 Va. Tax Rev. 639), titled "A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant." I submit that article for the record. When the editor wrote to me in April 2004, I believe, that the final editing was complete, I emailed my article to about a dozen senior officials at Treasury and the Service. About three days after that, this issue first appeared on the Treasury-IRS Priority Guidance Plan, where it remained until late 2009—about four and a half years with no visible results—before it was unceremoniously removed—and without explanation.

NSSTA fears the use of the qualified settlement fund because it gives the plaintiffs the opportunity to structure without involvement of the defense. As early as 1997, NSSTA began to discourage the use of the QSF, except in mass torts. It turned to its tax counsel, the law firm of Hogan & Hartson, who came up with the theory that a qualified settlement fund created for a single claimant resulted in that claimant having economic benefit in the funds. In more than one instance Hogan & Hartson claims that some officials at the Service agree with their theory of economic benefit attaching when there is but a single claimant. Details of that effort appear in my *Virginia Tax Review* article, beginning at page 673.

The economic benefit theory being promulgated by the defense is the new canard to replace the old one. You remember: "Knowledge of the cost of the annuity is constructive receipt."

The irony here was that NSSTA's stated mission is to promote the use of structured settlements. But, in this case, it was looking for a way to stop them from being arranged without the defense participation. They were—and still are, in effect, discouraging the use of structured settlements, rather than promoting them.

As soon as NSSTA discovered the request to Treasury in June 2003 by the Society of Settlement Planners for published guidance on the single-claimant issue, it wrote a letter urging that the guidance not be published. NSSTA did not advance any viable tax theory as to why a single claimant should be deemed to have economic benefit. They simply didn't want the guidance to be published. That seems to be their mantra. "Just don't publish the guidance." I note that John Stanton of Hogan & Hartson has submitted written comments for this hearing and is scheduled to appear on behalf of NSSTA. I believe Mr. Stanton has submitted the 2003 NSSTA letter for the record of these proceedings. This is simply another way of saying "Just don't publish the guidance." Mr. Stanton's stated purpose of being here today is to refute my suggestion that the economic benefit issue can be resolved easily in the proposed revision to section 1.104 of the Regulations, on the basis that my suggestion exceeds the scope of the proposed revision. Of course, the scope should be whatever is "needful" in order to clarify Code section 104. I suppose

I should be flattered that NSSTA views me as a threat to disrupting the status quo. I hope that speaks for the credibility of my remarks today.

Now, let's get to the tax issues:

I understand that the branch responsible for this project—Branch 4—has limited the scope of the proposed revision to a couple issues in order to avoid the type of controversy that has stalled this project in the past. But, the scope of this project should be determined by the necessity for guidance related to Tax Code section 104, and not limited for the convenience of the staff. This issue is primarily a Code section 104 issue, and the corresponding Regulation is an appropriate place to clarify how the Code will be interpreted. I sincerely hope that you will recognize the legitimate need to clarify and that the law requires such clarification.

Section 7805(d) of the Code says "[T]he Secretary of the Treasury shall prescribe all needful rules and regulations for the enforcement of this title." [Meaning title 26 of the U.S. Code, of course.] There is simply a duty to the taxpayer constituency—a statutory duty at that—to provide the guidance. This need is compounded by the fact that certain people within this building reportedly have made comments being used by the defense community to promote fear among those who would otherwise employ the qualified settlement fund for the benefit of their clients.

The campaign against the use of the qualified settlement fund has been effective in at least one other regard. Several life insurance company members of NSSTA refuse to accept qualified assignments from 468B funds when there is a single claimant, by their definition, which often includes a family group with competing claims.

I am not asking the Service to develop a new policy to clarify this issue. I submit that the policy is already in existence, except that one must go to several sources to piece it together. The proposed scope of the revision is to incorporate some legislative history dating back to 1996. That's 14 years ago. What about the legislative history from 1982 that never got included in the Regulations? That's 28 years ago, twice as long.

I have elaborated in my earlier written submission on the policy that already exists. That submission is cited as 2009 TNT 192-21. I also covered it in more depth in my Virginia Tax Review article. Here is a summary:

- Revenue Rulings 77-230, 79-220 and 79-313 creating an exception to the constructive receipt and economic benefit doctrines for structured settlements
- Periodic Payment Settlement Tax Act of 1982, which codified the revenue rulings, concurring with the Service
- Technical and Miscellaneous Revenue Act of 1988, allowing security interest in the annuity without causing economic benefit or constructive receipt.
- Victims of Terrorism Tax Relief Act of 2001, confirming congressional intent that the economic benefit doctrine should not be expansively interpreted
- Revenue Ruling 2003-115, providing guidance for a structured settlement with a qualified settlement fund established for the benefit of a single claimant from the 9/11 attack
- *Childs v. Commissioner*, 103 T.C. 634 (1994), *aff'd* 89 F.3d 865 (11th Cir. 1996), providing controlling authority that economic benefit does not attach to any payee in

a structured settlement, so long as the payee has only the rights to the future payments and does not control the qualified funding asset

- PLR 97-36032, favoring four taxpayers who were each sole beneficiaries of identical qualified settlement funds, declaring that there would be no inclusion in their gross income
- PLR 97-03038, allowing periodic payments to a single claimant from a trust acting as an assignee
- PLR 200836019, recognizing the concept of a "non-qualified assignment" and that it can defer current year recognition of income

I urge this panel to consider also the writings of Jeremy Babener, who has submitted his article on the single claimant issue for the record. It is titled "Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History" and it has been accepted for publication in the New York University *Journal of Legislation & Public Policy*. Mr. Babener makes a similar analysis.

The point is that all of these events that I have described above and in detail in my previous submission, as well as in my *Virginia Tax Review* article, demonstrate that Congress, Treasury (including the IRS) and the Courts have spoken on the single claimant issue, confirming that economic benefit does not attach in periodic payment arrangements. The rule distilled from all of these events can be appropriately inserted into the corresponding Regulations for Code section 104. I have previously provided proposed text—one single paragraph—for your consideration.

I understand the workings of bureaucracies, having served as a commander, general's aide and staff officer in the U.S. Air Force and having headed a bureau-level federal agency. I know that there may be a reluctance to take on this issue when Treasury let it languish for more than four years before finally dropping it. But, the need to clarify the single claimant issue still exists, and so does the opportunity to clarify with this revision to the Regulations.

I support the expansion of the scope for other reasons than the economic benefit issue. Attorneys David Higgins and John McCulloch have proposed some thoughtful suggestions for defining what constitutes a "personal physical injury or physical sickness" within the meaning of Code section 104(a)(2).

As a practitioner who has been involved in periodic payment tax issues since 1986, I can attest to the need for published rules on the application of the economic benefit doctrine to amounts received to resolve claims. I urge Treasury and the Service to adopt the text I have proposed and incorporate it into Income Tax Regulations section 1.104.

Please don't forget: You are here to serve the people—not the other way around.

Thank you for this opportunity to speak on the record and for your thoughtful consideration.

A CASE FOR THE URGENT NEED TO CLARIFY TAX TREATMENT OF A QUALIFIED SETTLEMENT FUND CREATED FOR A SINGLE CLAIMANT

Richard B. Risk, Jr.[*]

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[*] J.D., University of Tulsa College of Law (2001), B.A., Oklahoma State University (1963). Admitted to practice in Oklahoma. He edits and publishes *Structured Settlements*™ newsletter, which is produced in personalized editions for numerous brokers across the country to distribute to their clients—primarily plaintiffs' attorneys—with a combined press run that approaches 15,000 copies each issue. The Internal Revenue Service has acknowledged Risk as an authority on I.R.C. § 130 qualified assignments using section 468B qualified settlement funds. He holds the designation of Certified Structured Settlement Consultant (CSSC) from the National Structured Settlements Trade Association and is a founding member and former director of the Society of Settlement Planners. Prior to becoming an attorney, Risk served in the U.S. Air Force as a commander and staff officer during the Vietnam era, as an executive with two energy corporations, and in the Senior Executive Service as head of an agency in the U.S. Department of Energy.

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"[T]he Secretary of the Treasury shall prescribe all needful rules and regulations for the enforcement of this title [Title 26, U.S. Code].
– I.R.C. § 7805(d)

I. INTRODUCTION

There is a pressing need for the Treasury—through the Internal Revenue Service (Service)—to issue guidance on the tax treatment of an Internal Revenue Code (Code) section 468B designated settlement fund (DSF) or qualified settlement fund (QSF) created for the benefit of a single claimant to facilitate a section 130 "qualified assignment" of a periodic payment liability. Injured claimants routinely are harmed a second time by self-insured entities and liability insurance companies when settlement or judgment terms include periodic payments.[1] The use of a DSF or QSF is effective in removing the adversarial party from involvement in the distribution of the claimant's damage proceeds.[2] However, assertions of potentially adverse tax treatment of the payments to injury victim payees are

[1] *See* Richard B. Risk, Jr., *Structured Settlements: The Ongoing Evolution from a Liability Insurer's Ploy to an Injury Victim's Boon*, 36 TULSA L.J. 865, 887-89 (2001).

[2] *Id.* at 892-901.

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causing victims either to forego tax-free periodic payments altogether or else place themselves at the mercy of the adversary.

If a tort claim for personal physical injury or sickness is resolved through judgment or settlement and the defendant's tort liability is extinguished in exchange for monetary consideration that includes a series of future periodic payments, future lump sums or some combination of the two, it is called a structured settlement.[3] The structured settlement concept is arguably this country's[4] most responsible means of indemnification for victims of physical injury or sickness.[5] While the structured settlement was likely invented in the

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[3] Congress defined the term "structured settlement" in the Victims of Terrorism Tax Relief Act of 2001, Pub. L. 107-134, § 115, 115 Stat. 2427 (2002) (codified at I.R.C. § 5891). Subsection 5891(c)(1) defines a "structured settlement," for purposes of that Code section, as

> an arrangement (A) which is established by (i) suit or agreement for the periodic payments of damages excludable from the gross income of the recipient under section 104(a)(2), or (ii) agreement for the periodic payment of compensation under any workers' compensation law excludable from the gross income of the recipient under section 104(a)(1), and (B) under which the periodic payments are (i) of the character described in subparagraphs (A) and (B) of section 130(c)(2), and (ii) payable by a person who is a party to the suit or agreement or to the workers' compensation claim or by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with section 130.

Id. § 589(c)(1). In reality, this definition is not fully inclusive, as there are structured settlements of taxable damages that are neither excluded under section 104(a) nor assignable under section 130.

[4] The concept has spread to the United Kingdom and Canada. On December 13, 2002, the Australian Federal Parliament passed legislation making tax-free structured settlements available in that country. *See* Press Release, Senator Helen Coonan, Minister for Revenue and Assistant Treasurer, Structured Settlements and Structured Orders (Dec. 13, 2002), *at* http://assistant.treasurer.gov.au/atr/content/pressreleases/2002/130.asp.

[5] A structured settlement's benefits primarily are twofold: (i) it protects against spendthrift behavior by the injury victim; and (ii) it adds the benefit of tax-free growth of the periodic payment funding asset, so long as the payee does not have constructive receipt or economic benefit of the asset. *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999) pt. III, *available at* http://www.house.gov/jct/x-15-99.htm. This is the first time that Congress has issued a statement of public policy pertaining to structured settlements. A lump sum damage payment on account of personal physical injury or physical sickness (except punitive damages) is otherwise excluded from gross income of the taxpayer. Since Code sections 104(a)(1) and (2) refer to payments made either at the time of settlement or over time, the growth of the annuity or Treasury obligation is

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mid-1960s, it first gained legitimacy in the late 1970s when the Service issued three revenue rulings on the tax treatment of periodic payments made to personal injury claimants.[6] However, the concept is tainted by the history of abuses perpetrated against claimants by the liability insurance industry in their quest to create profit centers within their claims departments.

Structured settlements were invented by the defense, and the marketing of the annuities that serve as the underlying assets to fund payments has been tightly controlled. Control was largely accomplished through the creation of the National Structured Settlements Trade Association (NSSTA), which operates as the alter ego of the insurance industry[7] and initially set the standard for how structured settlements were handled.[8] Brokerages, initially comprising primarily former property and casualty (P&C) insurance claims personnel, were organized as the structured settlement marketing distribution system. At the behest of annuity brokerages, life insurance companies affiliated with the liability insurers and unaffiliated life companies joined NSSTA and created barriers to entry. For example, life insurance agents otherwise licensed to sell annuities could not participate. This pattern persists today; structured settlement brokerages are touted as specialists, and insurance agents are prohibited from being appointed to sell structured settlement annuities unless they join one of the brokerages.[9]

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also tax-free. I.R.C. §§ 104(a)(1)-(2).

[6] *See* Rev. Rul. 77-230, 1977-2 C.B. 214; Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75. Congress codified the results of these rulings in the Periodic Payment Settlement Tax Act of 1982. Pub. L. 97-473, § 101, 96 Stat. 2605 (1983) (codified at I.R.C. § 104(a)).

[7] NSSTA voting membership is limited under the group's bylaws to a single representative of each member life insurance company (Provider Member) and of each brokerage (Producer Member). A third influential group, the liability insurance companies (User Members), has no vote but exerts control over the brokerages on their "approved broker" lists and through their affiliated life insurance companies. Most self-insured corporations and liability insurers that have *quid pro quo* arrangements with brokerages to handle the structured settlement aspects of their physical injury liability claims are not members of NSSTA. NSSTA, *Bylaws*, Article II, *in* NSSTA MEMBERSHIP DIRECTORY 2003-2004.

[8] NSSTA's influence has waned with the assertion of plaintiffs' rights to select the broker and annuity provider, but NSSTA still facilitates defense efforts to maintain control. I discuss some of these efforts *infra* in Part III.

[9] In *Weil Insurance Agency v. Manufacturers Life Insurance Co.*, several plaintiff brokers sued several annuity issuers and defense brokerages in federal district court based on their defense-only policy, which denied information on costs of structured settlements to brokers who did business with tort plaintiffs. 815 F. Supp.

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1320 (N.D. Cal. 1992). In upholding summary judgment for the defendants, the Court of Appeals for the Ninth Circuit found that, while exclusion of a competitor may be a prerequisite for finding that a refusal to deal violates antitrust laws, it is not enough to sustain a finding of antitrust injury. *See* Legal Econ. Evaluations, Inc. v. Metro. Life Ins. Co., 39 F.3d 951, 951 (9th Cir. 1994). The court said antitrust laws are concerned about injury to competition, not competitors. *Id.* The appellate court acknowledged the injury that occurs from defense-only brokerages, but said, "Weil's injury does not flow from these competitive harms." *Id.* at 953. The plaintiffs had settled with two of the defendants by the time the appeals court ruling was made. However, the impact of this litigation was positive in that it influenced the life insurance markets to remove restrictions against doing business with plaintiffs.

See also the related case of *Manufacturers Life Insurance Co. v. Superior Court*, 895 P.2d 56, 58 (Cal. 1995). A settlement annuity broker had brought action against a life insurer, other insurers, competing insurance brokers, trade associations, and an officer of a competing brokerage to recover for violations of several state antitrust acts by boycotting the broker's business. The Supreme Court of California, en banc, affirmed the Court of Appeals, holding that (1) the Unfair Insurance Practices Act (UIPA) does not exempt a life insurance company from antitrust laws of the Cartwright Act and unfair business practice laws of the Unfair Competition Act, and (2) a cause of action for unfair competition based on conduct made unlawful by the Cartwright Act is not prohibited by the fact that the UIPA does not create a private civil cause of action.

The barrier to entry remained after *Weil*, as evidenced by a letter addressed to the author from Delphine Evans, Associate, Capital Initiatives (Apr. 9, 1990) (on file with author), in response to the author's inquiry about being appointed by that company to sell its structured settlement products. Typical of the annuity market policy is the text of this letter from Capital Initiatives, which was later absorbed by AEGON Financial Services, Louisville, Ky. (which exited the structured settlement marketplace in 2003). The letter says in part:

> Due to the highly technical and legally complex nature of the structured settlement business, consultants must be able to document their legal and technical expertise in the area of structured settlements. One of the ways Capital Initiatives ensures this expertise is by restricting our licensing to companies that specialize in doing primarily structured settlement business. This approach is designed to avoid unduly exposing Capital Initiatives to the many and significant liabilities associated with the structured settlement business.
>
> In order to ensure that Capital Initiatives provides superior service to our structured settlement consultants, we limit the number of consultants we license. . . .
>
> In order to meet our aggressive production goals and to ensure a mutually beneficial relationship, prospective consultants must be able to document the ability to produce at least $2.5-3.0 million in annual premium with Capital Initiatives.

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Brokerages formed alliances with self-insured defendants and liability insurers for the exclusive right to handle all structured settlement transactions resulting from the resolution of tort claims.[10] Initially, the *quid pro quo* of these alliances, in exchange for the broker's exclusive arrangement, was simply the broker's ability to make the money being offered to resolve the tort claim appear to the claimant to be a much larger amount.[11] In the 1980s, the practice of rebating part of the commission from the annuity sale back to the liability insurer became the marketing plan for many, if not most, structured settlement brokerages.[12]

This lucrative business has grown to more than $6 billion in annual premiums for annuity sales.[13] It is easy to see why those who have controlled this industry for more than two decades—and have become very wealthy in the process—do not wish to give it up.

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[10] See *infra* note 108 and accompanying text for discussions of alliances between brokerages and defendants and their insurers.

[11] The insurers capitalized on the fact that the time value of money apparently is not widely understood by unsophisticated claimants to make the present value or actual cost of the settlement appear larger than it actually was. They and the brokers who worked with them refused to divulge the cost of the annuity, telling the claimants that knowledge of the cost constituted constructive receipt, which caused the loss of tax benefits. This canard was dispelled by two private rulings. Priv. Ltr. Rul. 83-33035 (May 16, 1983) (disclosure by the defendant of the existence, cost, or present value of the annuity will not cause the payee to be in constructive receipt of the present value of the amount invested in the annuity); Priv. Ltr. Rul. 90-17011 (Jan. 24, 1990) (knowledge of the existence, cost and present value of the annuity contract used to fund the settlement offer . . . will not cause the family to be in constructive receipt of the amount payable under the annuity contract or the amount invested in the annuity contract). However, the use of tax treatment uncertainty is still a favorite intimidation weapon of the defense, as will be developed in this article.

[12] It was the proliferation of rebating that prompted the request for a study on its legality conducted by LeBoeuf, Lamb, Leiby & MacRae, of Washington, D.C., and reported in a letter from L. Charles Landgraf, May 3, 1989, "Commission Rebates by Structured Settlement Brokers," to Randy Dyer, Executive Vice President, NSSTA. This report and the failure of the industry to act on it are discussed in greater detail later in this article. *See infra* note 109 and accompanying text.

[13] NSSTA announced that structured settlement annuity premium sales by its members during 2002 reached $6.12 billion. *See* Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003) (on file with author). The universal commission rate for structured settlement annuities is 4 percent, according to the author's experience. Based on $6.12 billion in sales, the total commission paid each year is $244.8 million, including commission withheld from the exclusive brokerages as indirect rebates by some life insurance companies or paid back to their P&C affiliates, as part of an "approved broker list" scheme.

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Congress did not intend for funds held temporarily in a QSF to constitute "economic benefit"[14] to claimants, even if the fund is created for ultimate distribution to a single claimant. Detractors have argued that economic benefit attaches, preventing the qualified assignment from taking place. This also deprives the injury victim of significant tax advantages.

The uncertain tax treatment of a single-claimant QSF is largely the result of internal tension among Treasury and Service officials. Those who enforce the rules, oversee audits, and issue private letter rulings reportedly are at odds with those who interpret the laws and make policy by issuing Treasury Regulations and other controlling directives. Efforts to obtain clarification on the tax treatment of single-claimant QSFs have been crippled by these conflicts within the government.

This article will argue that Congress does not intend for the judicial doctrine of economic benefit to apply to a DSF or QSF[15] created for the benefit of a single claimant. It will also demonstrate why it is appropriate and necessary that Treasury and the Service issue guidance at this time.

II. THE TAX CASE FOR MY ARGUMENT

The technical arguments of congressional intent are straightforward, gleaned from the statutes and their amendments as well as committee reports. Based on these sources, it is apparent that Congress did not intend for the judicial doctrine of economic benefit to apply to the facts of a designated settlement fund or qualified settlement fund created for the benefit of a single claimant.

My analysis begins with the premise that, except as otherwise provided in the Code, gross income means all income from whatever source derived.[16] If there is no exclusion, all monies received from the transferor by the QSF are taxable to the claimant. There can be no qualified assignment.

In order to determine that a QSF may make a qualified assignment to a single claimant within the meaning of section 130(c), I

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[14] Used as a term of art here, the judicially created doctrine of "economic benefit" is discussed *infra* in Part II.B.2.

[15] For purposes of this discussion, references hereafter generally will be to the QSF. However, since they both stem from the authority of Code section 468B, a reference to a QSF will be understood to apply also to a DSF. Exceptions will be made when a reference to a DSF is specifically intended.

[16] I.R.C. § 61(a).

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will show that the QSF's assignments will comply with the requirements of Code sections 104(a)(2), 130, and 468B, as well as Treasury Regulations section 1.468B, and Revenue Procedure 93-34, 1993-2 C.B. 470.[17]

A. Compliance with Section 104(a)(2)

Section 104(a)(2) generally excludes from income the amount of any non-punitive damages received on account of personal physical injuries or physical sickness.[18] The House Report accompanying the Small Business Job Protection Act of 1996, which modified the exclusion of damages by adding the word "physical" before injury and sickness and specified that the exclusion does not apply to punitive damages, created an origin-of-the-claim test:

> If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party. For example, damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of such individual's spouse are excludable from gross income.[19]

Whether punitive damages were ever pled or discussed is also relevant to determining whether the exclusion from gross income under section 104(a)(2) applies. As the 1995 case of *Bagley v. Commissioner* demonstrates, the Service will not necessarily accept a court's classification of damage.[20] In *Bagley*, a settlement allocated entirely to non-taxable compensatory damages was reallocated to taxable punitive damages. Likewise, in *Amos v. Commissioner*, the

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[17] *See id.* §§ 104(a)(2), 130, 468B; Treas. Reg. § 1.468B (1992); Rev. Proc. 93-34, 1993-2 C.B. 470. Treasury Regulations § 1.104-1, which corresponds to Code section 104(a), offers no substantive additional guidance pertinent to this analysis. Treas. Reg. § 1.104-1 (as amended in 1970). In fact, this section of the Income Tax Regulations has not been updated to incorporate revisions to section 104 resulting from the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605(a)-(c), 110 Stat. 1755 (1996), which taxes punitive damages and damages not attributable to physical injuries or physical sickness.

[18] I.R.C. § 104(a).

[19] H.R. REP. NO. 104-586, at 1 (1996).

[20] 105 T.C. 396 (1995).

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Tax Court reallocated forty percent of non-taxable physical injury damages claimed by the petitioner to taxable non-physical compensation for agreeing to a confidentiality covenant, since the physical injury was not considered extensive enough by the Service or the court to warrant the amount of damages paid by the defendant.[21] In another case, *Barnes v. Commissioner*, the court looked to the record to determine what kind of damages the settlements payments were made in lieu of.[22] If the settlement agreement is silent on the issue, the Service will go to the pleadings and other evidence to determine what motivated the payor to pay the settlement amount.[23] In *Barnes*, there was no specific mention of an allocation between excludable personal injury damages and punitive damages in the settlement agreement. Punitive damages were mentioned in the pleadings and the plaintiff's attorney had mentioned in the negotiations that there was a "likelihood" of punitive damages.[24] The Tax Court held that the damages should be allocated one-half to taxable punitive damages and one-half to excludable personal injury damages.[25] If there is any doubt that punitive damages might become an issue, the settlement documents should be clear that the allocation is not just an accommodation to one of the parties, but an arms-length transaction.

B. Compliance with Section 130

Under section 130(a), any amount received for agreeing to a qualified assignment is not included in gross income to the extent that

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[21] Amos v. Commissioner, 86 T.C.M. (CCH) 663 (2003). During a 1997 professional basketball game between the Chicago Bulls and the Minnesota Timberwolves, Dennis Rodman of the Bulls landed on a group of photographers, causing minor physical injuries to photographer Eugene Amos which were compounded when Rodman kicked Amos in the groin. The parties entered into a "Confidential Settlement Agreement and Release" providing a lump sum payment of $200,000 to the photographer and containing extensive confidentiality provisions for the benefit of Rodman, including the amount paid to Amos. The Service had sent a notice of deficiency to Amos based on all but one dollar being taxable damages. The Tax Court was more sympathetic to Amos, allowing $120,000 for his injuries, but still reallocating $80,000 or forty percent as taxable compensation for the confidentiality aspect of the settlement. The court asserted that the total amount of the settlement was too high to be exclusively for actual physical injuries sustained.

[22] Barnes v. Commissioner, 73 T.C.M. (CCH) 1754, 1756 (1997).

[23] *Id.*

[24] *Id.*

[25] *Id.*

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amount does not exceed the aggregate cost of any qualified funding assets.[26] Section 130(c) defines a "qualified assignment" as any assignment of a liability to make periodic payments as damages, whether by suit or agreement, on account of personal injury or sickness (in a case involving physical injury or sickness) provided certain conditions are met:

> (1) if the assignee assumes such liability from a person who is a party to the suit or agreement, or the workmen's compensation claim, and
> (2) if—
> (A) such periodic payments are fixed and determinable as to amount and time of payment,
> (B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments,
> (C) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and
> (D) such periodic payments are excludable from the gross income of the recipient under paragraph (1) or (2) of section 104(a).[27]

Section 130(d) defines the term "qualified funding asset" to mean any annuity contract issued by a company licensed to do business as an insurance company under the laws of any state, or any obligation of the United States, if:

> (1) such annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment,
> (2) the periods of the payments under the annuity contract or obligation are reasonably related to the periodic payments under the qualified assignment, and the amount of any such payment under the contract or obligation does not exceed the periodic payment to which it relates,
> (3) such annuity contract or obligation is designated by the taxpayer (in such manner as the Secretary shall by regulations prescribe) as being taken into account under this section with respect to such qualified assignment, and
> (4) such annuity contract or obligation is purchased by the taxpayer not more than 60 days before the date of the

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[26] I.R.C. § 130(a).

[27] *Id.* § 130(c).

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> qualified assignment and not later than 60 days after the date of such assignment.[28]

The Periodic Payment Settlement Act of 1982 added section 130 and amended section 104(a)(2) to exclude personal injury damages received as periodic payments from the recipient's gross income, whether by suit or agreement.[29] The new provision of section 104(a)(2) was intended to codify existing law as reflected in Revenue Rulings 77-230, 79-220 and 79-313.[30] References to constructive receipt and economic benefit are not included in either section 104 or 130. However, Congress stated that:

> The periodic payments of personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments.[31]

1. Constructive Receipt

Section 451 provides that "the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period."[32] Section 1.451-1(a) of the Treasury Regulations states that gains, profits, and income are to be included in gross income from the taxable year in which they are actually or constructively received by the taxpayer, unless includable for a different year in accordance with the taxpayer's method of accounting.[33] Under the cash receipts and disbursements method of accounting, such an amount is includable in gross income when actually or constructively received.[34]

Treasury Regulations section 1.451-2(a) provides in part that

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[28] *Id.* § 130(d).

[29] Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, § 104(a), 96 Stat. 2605, 2605 (1983) (codified at I.R.C. § 130).

[30] *See* Rev. Rul. 77-230, 1977-2 C.B. 214; Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.

[31] S. REP. NO. 97-646, at 4 (1982).

[32] I.R.C. § 451.

[33] Treas. Reg. § 1.451-1(a) (as amended in 1999).

[34] *Id.*

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income, although not actually reduced to a taxpayer's possession, is *constructively received* in the taxable year during which it is credited to this account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given.[35] However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.[36]

2. Economic Benefit

The doctrine of "economic benefit" requires a determination that the actual receipt of property or the right to receive property in the future confers a current economic benefit on the recipient.[37] The doctrine applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for a taxpayer's sole benefit.[38]

In *Sproull v. Commissioner*, the court applied the economic benefit doctrine to tax amounts an employer paid to an interest-bearing trust as compensation for an employee's past services.[39] No one other than the employee had any interest in or control over the monies in the trust, and the employee was required to take no further action to earn or establish his rights to the amounts in trust.[40] The trustee's duties were limited to holding, investing, and paying the amounts in trust to the employee or his estate in the event of his prior death in the two taxable years following the creation of the trust.[41] The Tax Court held that "there is no doubt that such an interest had a value equivalent to the amount paid over for his benefit."[42]

The economic benefit doctrine does not apply where the beneficiary's ability to obtain trust amounts is subject to a future condition or forfeiture.[43] The *Sproull* Court noted that "the trust

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[35] Treas. Reg. § 1.451-2(a) (as amended in 1979).

[36] *Id.*

[37] *See* Minor v. United States, 772 F.2d 1472 (9th Cir. 1985).

[38] *See* Sproull v. Commissioner, 16 T.C. 244, 247 (1951); Rev. Rul. 60-31, 1960-1 C.B. 174 (Situation 4).

[39] 16 T.C. 244, 247 (1951).

[40] *Id.*

[41] *Id.*

[42] *Id.* at 248.

[43] Drysdale v. Commissioner, 277 F.2d 413 (6th Cir. 1960) (taxpayer did not have economic benefit of funds placed in trust by employer where the use of funds was conditioned upon taxpayer's death, his reaching the age of sixty-five, or his

agreement contained no restriction whatsoever on petitioner's right to assign or otherwise dispose of the interest, thus created no restriction in him."[44] Other courts have noted that a taxpayer may still have an economic benefit in a trust where there are restrictions on assignment.[45] However, there is no economic benefit when the beneficiary's right to receive the income is restricted or conditioned upon future events.[46] Therefore, in order for a taxpayer to include an amount in income under the economic benefit doctrine, the amount must be set aside irrevocably, for the taxpayer's sole benefit, without restrictions or conditions based upon the occurrence of future events.

Congress has softened its stand on the economic benefit doctrine and whether it renders a periodic payment obligation unassignable under section 130. As initially enacted in 1983, section 130 restricted the rights a claimant has against the assignee and in the assets used to fund future periodic payments.[47] Congress repealed section 130(c)(2)(C) in 1988[48] because, in Congress's view, "[r]ecipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of the tax law."[49]

Congress also provided much greater rights to payees in structured settlements with the enactment of the Victims of Terrorism Tax Relief Act of 2001, which added section 5891 to the Code.[50]

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retirement from full time activity); Minor v. United States, 772 F.2d 1472 (9th Cir. 1985) (taxpayer did not have economic benefit in funds placed in trust under deferred compensation agreement where funds were conditioned upon taxpayer's limiting his practice after retirement and not competing with present employer).

[44] 16 T.C. at 248.

[45] *See* United States v. Drescher, 179 F.2d 863 (2d Cir. 1950) (employee received economic benefit of annuity contract purchased by employer in the year such contract was delivered to him, even though such contract was non-assignable).

[46] *See Minor*, 772 F.2d at 1475-76.

[47] *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101, 96 Stat. 2605, 2605-2606 (1983) (codified at I.R.C. § 130).

[48] I.R.C. § 130(c)(2)(C) (repealed 1988). Public Law 100-647, section 6079(b)(1)(A), deleted Code section 130 subparagraph (c)(2)(C) and redesignated subparagraphs (c)(2)(D) and (c)(2)(E) as subparagraphs (c)(2)(C) and (c)(2)(D). Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A), 102 Stat. 3342, 3710 (1988). The deleted subsection read as follows: "(C) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor." 26 U.S.C.A § 130 History, Ancillary Laws and Directives (1999).

[49] H.R. REP. NO. 100-795, at 541 (1988).

[50] *See* Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (codified at I.R.C. § 5891).

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Section 5891 regulates factoring transactions by imposing a forty percent federal tax on the factoring discount unless approved in advance by an applicable state court.[51] This section also gives payees the ability to transfer structured settlement payment rights (including portions of structured settlement payments) made for consideration by means of sale, assignment, pledge, or other form of encumbrance or alienation for consideration.[52] These new rights go far beyond those of the payee in Revenue Ruling 79-220. Under that ruling, the payee could receive only the monthly payments—he could not have the actual or constructive receipt or the economic benefit of the lump sum that was invested to yield that monthly payment.[53]

The developments following the codification of Revenue Ruling 79-220 in the Periodic Payment Settlement Tax Act of 1982 indicate that a more lenient interpretation of constructive receipt and economic benefit is appropriate for structured settlements. The definitions of constructive receipt and economic benefit are to be construed much more narrowly when applied to structured settlements than to other deferred compensation situations when congressional intent is considered.

C. Initial Qualification Under Treasury Regulations § 1.468B and Compliance with Revenue Procedure 93-34

Treasury Regulations section 1.468B-1(a) provides that a QSF is a fund, account, or trust that satisfies all the requirements of section 1.468B-1(c).[54] Section 1.468B-1(c) generally provides that the fund, account, or trust is a QSF if: (1) it is established pursuant to an order of, or is approved by, a court of the United States or any state (including the District of Columbia) and is subject to the continuing jurisdiction of that authority; (2) it "is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability arising" out of tort, breach of contract, or violation of law; and (3) the "fund, account, or trust must be a trust under applicable state law, or its assets must be otherwise segregated from other assets of the

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[51] I.R.C. § 5891(a).

[52] *Id.* § 5891(c)(3)(A).

[53] Rev. Rul. 79-220, 1979-2 C.B. 74. Revenue Ruling 79-220 is discussed in more detail later in this article. *See infra* Part II.D.

[54] Treas. Reg. § 1.468B-1(a) (as amended in 1993).

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transferor (and related persons)."[55]

Under Revenue Procedure 93-34, a DSF described in Code section 468B(d)(2) or a QSF described in Treasury Regulations section 1.468B-1 will be considered "a party to the suit or agreement" for purposes of Code section 130 if each of the following requirements is satisfied:

> (1) the claimant agrees in writing to the assignee's assumption of the designated or qualified settlement fund's obligation to make periodic payments to the claimant;
> (2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) . . .;
> (3) each qualified funding asset purchased by the assignee in connection with the assignment by the designated or qualified settlement fund relates to a liability to a single claimant to make periodic payments for damages;
> (4) the assignee is not related to the transferor (or transferors) to the designated or qualified settlement fund within the meaning of sections 267(b) or 707(b)(1); and
> (5) the assignee is neither controlled by, nor controls, directly or indirectly, the designated or qualified settlement fund.[56]

If these requirements are satisfied, and if the requirements of section 130 are satisfied, then the assignment is a qualified assignment within the meaning of section 130 and the transferor to the QSF will not be treated as receiving a deemed distribution from the fund to the transferor when the qualified assignment is made. If, based on the documents reviewed, representations made and information provided, the settlement qualifies as a QSF and will continue to qualify as long as it is administered under the terms of the QSF agreement approved by the court, the settlement may make a qualified assignment of the periodic payment obligation under the provisions of Code section 130, even if the QSF is created for the benefit of a single claimant.[57]

D. Structured Settlements Are Specifically Carved Out of the Economic Benefit Rule

Congress created an exception to the broad rule established by

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[55] *Id.* § 1.468B-1(c).

[56] Rev. Proc. 93-34, 1993-2 C.B. 470.

[57] *See id.*

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case law defining economic benefit as applied to structured settlements.[58] Revenue Ruling 79-220 was one of three key rulings that were later codified by the Periodic Payment Settlement Tax Act of 1982.[59] The facts of that ruling were as follows:

> [T]here is a continuing obligation by *M* to $250 per month to *A* for the agreed period. *M*'s purchase of a single premium annuity contract from the other insurance company was merely an investment by *M* to provide a source of funds for *M* to satisfy its obligation to *A*. See Rev. Rul 72-25, 1972-1 C.B. 127, which relates to a similar arrangement made by an employer to provide for payment of deferred compensation to an employee. In Rev. Rul. 72-25, as here, the arrangement was merely a matter of convenience to the obligor and did not give the recipient any right in the annuity itself.[60]

On these facts, the Service held:

> The exclusion from gross income provided by section 104(a)(2) of the [Internal Revenue Code of 1954] applies to the full amount of the monthly payments received by *A* in settlement of the damage suit because *A had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump-sum that was invested to yield that monthly payment.* If *A* should die before the end of 20 years, the payments made to *A*'s estate under the settlement agreement are also excludable from income under section 104.[61]

Under the facts of Revenue Ruling 79-220, the single premium immediate annuity purchased by *M* as a convenience to *M* to fund its obligation to *A* is an amount set aside irrevocably for *A*'s sole benefit.[62] Economic benefit applies, according to *Sproull*, when assets are unconditionally and irrevocably paid into a fund or trust to be used for a taxpayer's sole benefit.[63] However, as in *Sproull*, the deciding factor in Revenue Ruling 79-220 was control. Sproull alone

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[58] H.R. REP. NO. 97-832, pt. II, at n.2 & Explanation of Provisions (1982).

[59] *Id.*

[60] Rev. Rul. 79-220, 1979-2 C.B. 74.

[61] *Id.* (emphasis added).

[62] *Id.*

[63] Sproull v. Commissioner, 16 T.C. 244, 247-48 (1951).

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had an interest in or control over the monies in the trust and was therefore required to take no further action to earn or establish his rights to the amounts in trust.[64] *A*, in contrast, had a right to receive only the monthly payments and thus had no right or control over the annuity. *A* was a single claimant.[65]

In the House of Representatives Report accompanying the Periodic Payment Settlement Tax Act of 1982, the Committee on Ways and Means summarized the present law pertinent to this issue in its "Explanation of the Bill," as follows:

> Rev. Rul. 79-220 holds that where the insurer of a tortfeasor purchases and retains exclusive ownership of a single-premium annuity contract to fund specified monthly payments for a fixed period pursuant to settlement of a damage suit for personal injuries, the recipient may exclude from his or her gross income the full amount of the payments, and not merely the discounted present value. *The taxpayer's only right with respect to the amount invested was to receive the monthly payments, and the ruling concluded that the taxpayer did not have actual or constructive receipt or economic benefit of the amount invested.* [66]

The same report, under reasons for change, clarified that Congress was accepting the Service's decision on the underlying facts of Revenue Ruling 79-220. It agreed with the Service that neither actual or constructive receipt nor economic benefit of the amount invested was triggered. The Report explained that

> [t]he bill specifically provides that the Code section 104 exclusion from gross income of damages for personal injuries or sickness applies whether the damages are paid as lump sums or as periodic payments. *This provision is intended to codify, rather than change, present law.* Thus, the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments. [67]

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[64] *Id.* at 248.

[65] Rev. Rul. 79-220, 1979-2 C.B. 74.

[66] H.R. REP. NO. 97-832, pt. II, at n.2 (1982) (emphasis added).

[67] *Id.* at pt. II (emphasis added). The pertinent text is identical in the Senate

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Thus, Congress expressed its intent that, in structured settlements, the judicial doctrine of economic benefit does not apply simply because a sum is set aside irrevocably for the payee's sole benefit—even if the payee is the only claimant who will benefit from the sum set aside. Certainly, Congress intended a bright line distinction in that economic benefit attaches only when the claimant is given control over the sum. Now that Congress has spoken on the issue by adopting the Service's interpretation as its own, neither Treasury nor the Service may override it.

When a sum is deposited into a QSF, the claimant is even further removed from benefit than *A* had been in the Revenue Ruling 79-220 scenario, where *A* was entitled to periodic payments generated by the annuity. When funds initially are deposited into a QSF, the claimant has no right either to that sum or to any periodic payments, because the tort claim held against the QSF has not been settled. Typically, a court having jurisdiction over the claim creates a QSF for the resolution of a physical injury or physical sickness claim.[68] The court continues its oversight over the QSF until the fund is terminated. When the sum is transferred into the QSF, the original defendant is dismissed. However, the cause must remain alive in order for the court to maintain its jurisdiction. This is accomplished by transferring tort liability to the QSF through a novation.[69] Thus, the claimant still has a property right—the tort claim—but has no right to receive any payment from the QSF. At this stage, the claimant agrees only that the amount deposited into the QSF will sufficiently settle the claim, allowing release and dismissal of the tortfeasor.

The QSF then enters into a settlement agreement with the claimant, the terms of which typically include a lump sum payment to cover costs, expenses, liens, immediate needs, a cash reserve, and attorney fees. Terms can also include periodic payments, and any

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version of the report to accompany H.R. 5470. S. REP. NO. 97-646, at 4 (1982)

[68] A QSF must be "established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority." Treas. Reg. § 1.468B-1(c)(1) (1993). This is broader than the Code, which says simply that a DSF (which covers the term QSF) means any fund "which is established pursuant to a court order and which extinguishes completely the taxpayer's tort liability . . . ." I.R.C. § 468B(d)(2)(A).

[69] A novation has the effect of adding a new party as substitute obligor who was not a party to the original duty, and discharging the original defendant by agreement of all parties, completely extinguishing any alleged liability of the defendant. *See* RESTATEMENT (SECOND) OF CONTRACTS § 280 (1981).

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income to the QSF is taxed to the QSF at the highest rate.[70] Revenue Procedure 93-34 allows the QSF to stand in the shoes of the original "party to the suit or agreement" to make a qualified assignment under section 130.[71] At that time, the cash lump sum is disbursed to the payee for actual receipt. The amount to fund the periodic payments is paid to a third-party assignee that, in turn, purchases the qualified funding asset (typically an annuity). In this process, the claimant never controls any of the funds deposited into the QSF, nor are the funds ever held in the QSF for the sole benefit of the payee. Again, this distinguishes the QSF from the Revenue Ruling 79-220 facts because the claimant in that ruling was given a right to receive payments from the annuity's assets, which were being held for the sole benefit of the claimant.[72] In a QSF, there is an even greater distance between the claimant and the amount being held in the QSF than under the Revenue Ruling 79-220 facts.

The selection of the QSF administrator typically is subject to the approval of the claimant. However, the QSF administrator's duty is to the QSF, to ensure that all liabilities of the QSF are extinguished by the time the assets of the QSF are depleted. The relationship between the claimant and the QSF is technically adversarial, although usually much less so than the relationship between the original parties or between the claimant and the tortfeasor's insurer. In any case, the claimant possesses no control over the QSF's assets—they are under the control of the QSF administrator and the court.

1. Single Claimant or Pre-Allocation Triggers of Economic Benefit Result in an Absurdity and Conflict with Canons of Professional Conduct

The assertion that there can be no allocation of the damage recovery amount among the claimants prior to the QSF being funded produces an absurd result. Under this theory, an allocation gives the individual the economic benefit of her portion of the damage recovery. Yet, every case requires an allocation before distribution occurs. Whether allocation occurs before the QSF is established or seconds before disbursement of funds, under this theory, economic benefit triggers. This means no QSF could ever originate a qualified

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[70] Treas. Reg. § 1468B-2(a) (1993) ("A qualified settlement fund is a United States person and is subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under section 1(e).").

[71] Rev. Proc. 93-34, 1993-28 I.R.B. 49.

[72] Rev. Rul. 79-220, 1979-2 C.B. 74.

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assignment—even when the QSF is established for the benefit of multiple claimants. Congress obviously did not intend this result.

The allocation theory discussed above also conflicts with the American Bar Association Model Rules of Professional Conduct.[73] Rule 1.8(g) states:

> A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients . . . unless each client consents after consultation, including disclosure of the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.[74]

The older American Bar Association Model Code of Professional Responsibility Disciplinary Rule DR 5-106(A) is essentially the same:

> A lawyer who represents two or more clients shall not make or participate in the making of an aggregate settlement of the claims of or against his clients, unless each client has consented by to the settlement after being advised of the existence and nature of all the claims involved in the proposed settlement, of the total amount of the settlement, and of the participation of each person in the settlement.[75]

Under allocation theory, economic benefit occurs if a global settlement amount offered for the benefit of multiple plaintiffs is allocated before the money is paid into a QSF or at any time before the money is distributed. However, if the attorney is to avoid a professional liability claim for violating the ethics standard applicable to her jurisdiction, all settling parties must be informed of their individual share before the offer is accepted. Nevertheless, this has not kept some attorneys from writing tax opinion letters that contravene both of these conclusions.

2. Unavoidable Single-Claimant Situations Should Not Cause Economic Benefit

Attributing economic benefit in section 130 assignment cases with a single claimant denies the benefit of tax-free periodic payments to

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[73] *See* Burrow v. Arce, 997 S.W.2d 229 (Tex. 1999) (adopting fee forfeiture as a remedy and remanding for trial the issue of whether the rule was violated).

[74] MODEL RULES OF PROF'L CONDUCT R. 1.8(g) (2002).

[75] MODEL CODE OF PROF'L RESPONSIBILITY, DR 5-106(A) (1980).

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certain types of claimants simply because the victim is unavoidably in single-claimant circumstances. It is doubtful that Congress intended this result, considering its stated position that the origin of the claim is the determining factor for eligibility, not the recipient of the physical injury.[76]

Section 468B allows a defendant in a mass tort case to settle before all the plaintiffs have been identified.[77] As an example of the potential injury wrought by the economic benefit theory, suppose an explosion and fire in a building where the number of occupants at the time of the accident cannot immediately be determined.[78] If only one body is recovered and the spouse brings suit on a negligence theory against the building owner, the court may be petitioned to establish a QSF in case more victims are later identified. If granted, the creation of the QSF releases the defendant from the tort liability to all victims because the QSF is substituted for the building owner under a novation. Thus, the QSF assumes all liability for the damages caused by the explosion and fire. If no more victims are identified, the entire fund assets may be paid to only one claimant. Certainly, the drafters of section 468B never intended to condition the availability of tax benefits on the existence of more than one victim.

Another potentially unjust single-claimant situation exists when state probate law requires that the estate's personal representative bring all claims in wrongful death cases on behalf of the estate. This representative is a single claimant, even though numerous heirs of the decedent might be in the position to receive distributions of any damage recover from the estate. It would have been quite anomalous for Congress to have intended section 468B to preclude the heirs in these situations from receiving the tax benefits of a structured settlement. Yet, those who maintain that the creation of a QSF for a single claimant automatically triggers economic benefit would do exactly that.

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[76] *See* H.R. REP. NO. 104-586, at 23 (1996) ("If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party.").

[77] I.R.C. § 468B.

[78] A recent example is the terrorist attack on the World Trade Center on September 11, 2001. Although it was certain that there was more than one victim, the exact number of people who perished was unknown for a long time. An explosion and fire in a smaller, largely vacant building might create a situation where only one victim could be initially identified, but the possibility of additional victims could not be ruled out for some time.

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3. Code Section 468B Was Not Created Exclusively for Mass Tort Cases

Prior to a 1988 amendment of section 468B, court-controlled class action settlement funds were not subject to tax at the fund level.[79] Instead, individual claimants were subject to income tax on their respective shares of fund earnings, when such earnings were paid to them. A provision taxing income earned by such funds had been included in the Tax Reform Act of 1986 but was omitted from the Code. Section 1810(f)(5)(A) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) added section 468B(g), which clarified Congress's intent to subject a settlement fund to current taxation regardless of whether a DSF election was made.[80]

Nothing in the legislative history of section 468B suggests that settlement funds were to be used exclusively for multiple-claim cases, that there needed to be a specific reason for the fund's creation, or that there was a specified minimum duration period for a fund's existence.[81] Yet opponents of the use of the QSF for single-claimant cases regularly assert all of these conditions.[82]

4. The Structured Settlement Carve-Out Does Not Apply to Other Deferred Compensation

Treasury and the Service need not be concerned that a narrow interpretation of the judicially created economic benefit doctrine for structured settlements establishes precedent for the narrowing of economic benefit when applied to other deferred compensation situations. The basic economic benefit doctrine is unchanged.[83]

As noted earlier, Congress has expressly noted on at least three occasions that economic benefit does not attach in structured settlement situations as easily as it might attach in other types of deferred compensation agreements. Court decisions in this area

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[79] I.R.C. § 468B.

[80] *See Taxation and Reporting of Qualified Settlement Funds*, TAX ADVISER (Am. Inst. of CPAs Inc., New York, N.Y.) (Apr. 1, 1996).

[81] *See generally* Donald B. Zief & William P. Van Saders, *Has "Homeless Income" Finally Found a Home?*, 67 TAXES 450, 453 (1989).

[82] *See, e.g.*, ALLSTATE, STRUCTURED SETTLEMENT REPORT (August 1, 1988).

[83] The internal opposition at the Service, according to oral reports given to the author, has come largely from staff members who work in the area of employee benefits. They fear that creating any exception to the economic benefit doctrine might weaken the Service's position toward deferred compensation agreements like the one in *Sproull v. Commissioner*, 16 T.C. 244 (1951), and other court decisions of that ilk.

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likewise suggest that a narrow interpretation of economic benefit is appropriate in the case of structured settlements. In *Childs v. Commissioner,* the Tax Court rejected the Service's position that the right of attorneys to receive periodic payments on behalf of their clients, in satisfaction of the clients' debt for attorney fees, was funded or secured.[84] The court held that the cost of the annuity contract funding the structured settlements received by the taxpayers in satisfaction of attorney's fees represented mere "unfunded promises," and did not constitute "property" under section 83.[85] Therefore, it was not taxable in the year of purchase. The issue appealed by the Service to the Eleventh Circuit was whether the purchase price of the annuities constitutes "property" per Code section 83 and, if so, whether that "property" was transferred.[86] The circuit court rejected the Service's position and upheld the Tax Court ruling.[87]

While the decision in *Childs* broadened the class of payees covered under structured settlements to include attorneys, it leaves intact the requirement that the periodic payments must result from a judgment or settlement where the payments to the claimant are on account of a personal physical injury or sickness within the meaning of section 104(a)(2). Congressional expression of the fact that economic benefit does not attach in structured settlement situations and the *Childs* decision take place in the context of periodic payments for section 104(a)(2) damages. The basic economic doctrine remains intact if Treasury and the Service issue the written guidance requested on whether a QSF established for the benefit of a single claimant may make a qualified assignment within the meaning of section 130. This is a carve-out that provides exceptions to the broad rule. The difference between structured settlements and other garden-variety deferred compensation agreements is easily distinguishable.

E. Summary

Congress has shown that it did not intend the judicial doctrine of economic benefit to apply to a designated settlement fund or qualified settlement fund created for the benefit of a single claimant. The single claimant would not have access to the amount transferred into the QSF because it is: (1) controlled by the QSF administrator, who is independent of the claimant; (2) subject to the continuing jurisdiction

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[84] 103 T.C. 634 (1994), *aff'd* 89 F.3d 865 (11th Cir. 1996).

[85] 103 T.C. at 635.

[86] *Id.*

[87] Childs v. Commissioner, 89 F.3d 865, 865 (11th Cir. 1996).

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of a court or other governmental agency; and (3) not even dedicated to the claimant's benefit until a settlement agreement between the claimant and the QSF is executed. Revenue Ruling 79-220 held that when funds or an asset (annuity) are held for the benefit of a claimant (a single claimant under those facts) to provide periodic payments, and the claimant has no control over those funds, the claimant does not have constructive receipt or economic benefit of those funds.[88] Under the facts of Revenue Ruling 79-220, the claimant was entitled to receive periodic payments generated by the assets being held for the claimant's benefit. Where the assets are simply being held in the QSF, the claimant rights has no rights to future payments until a settlement agreement is executed.[89] This creates additional distance between the funds and the claimant that did not exist in the facts of Revenue Ruling 79-220, strengthening the argument that there is no economic benefit.

Congress specifically agreed, through the legislative history of both the House and Senate for the Periodic Payment Settlement Tax Act of 1982, with the Service's interpretation and findings in Revenue Ruling 79-220. It accepted that neither constructive receipt nor economic benefit should apply when the single claimant had no control over the funds being held for his benefit.[90] Congress expressly stated that it was codifying the existing law.[91]

The congressional intent in the Periodic Payment Settlement Tax Act of 1982 is clear and unambiguous. Allocation theory, which turns every QSF claimant into a single claimant at the instant there is an allocation of the QSF's assets, results in absurdity. It renders all QSFs unable to make a qualified assignment, and is in conflict with the ABA Model Rule of Professional Conduct 1.8(g) and the ABA Model Code of Professional Responsibility's Disciplinary Rule 5-106(A).[92] Moreover, certain situations result in unavoidable single claimants, and Congress never intended to exclude them.

Congress has indicated through subsequent legislation, such as the Technical and Miscellaneous Revenue Act of 1988 and the Victims of Terrorism Tax Relief Act of 2001, that the economic benefit doctrine

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[88] Rev. Rul. 79-220, 1979-2 C.B. 74.

[89] *Id.*

[90] *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 976-473, 96 Stat. 2605 (1983) (codified at I.R.C. § 104(a)); H.R. CONF. REP. NO. 97-984 (1982); H.R. REP. NO. 97-832, pt. II, n.2 (1982); S. REP. 97-646, pt. II, n.2 (1982).

[91] H.R. REP. NO. 97-832, pt. II, Explanation of Provisions (1982).

[92] *See* MODEL RULES OF PROF'L CONDUCT R. 1.8(g) (2002); MODEL CODE OF PROF'L RESPONSIBILITY DR 5-106 (1981).

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should not be expansively interpreted. The narrower definition of economic benefit provides the claimant some rights for the payee in the funding asset itself that *Sproull* and successive case law has not allowed in defining the broad rules of the economic benefit.[93] Decisions by the courts also suggest a narrower definition of economic benefit in the case of structured settlements. The Tax Court's decision in *Childs*, as affirmed by the Eleventh Circuit, confirms that the economic benefit doctrine does not apply even to attorneys who collect all or part of their attorney fees in periodic payments from clients entitled to damages excluded under section 104(a)(2).[94] Congressional action and the decision in *Childs* provide controlling authority that economic benefit does not attach to any payee in a structured settlement, so long as the payee has only the rights to the future payments and does not control the qualified funding asset. The claimant may, however, have a right to a security interest in the funding asset, and he may sell, assign, pledge, encumber by some other form, or alienate by consideration the future payments.

III. THE CASE FOR TREASURY TO ACT IMMEDIATELY

Assuming that a qualified assignment can be made from a single-claimant QSF, the important matter is whether Treasury and the Service will provide written guidance. I argue that the Secretary of the Treasury is obligated to issue written guidance on this matter.

To put this discussion in perspective, one needs to understand (1) the rampant tortious and possibly illegal conduct that exists today in the structured settlement industry; (2) the public policy that is violated in the course of this conduct; (3) the false doubts created by the property and casualty (P&C) companies and those who collaborate with them to perpetuate the illegal and tortious activity; and, (4) the anxiety and uncertainty created in the public by the mixed signals emanating from Treasury and the Service.[95]

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[93] *See* Sproull v. Commissioner, 16 T.C. 244 (1951).

[94] I.R.C. § 104(a)(2); Childs v. Commissioner, 103 T.C. 634 (1994), *aff'd*, 89 F.3d 856 (11th Cir. 1996).

[95] These issues were not presented to Treasury and the Service by Skadden, Arps, Slate Meagher & Flom. *See* Letter from Fred Goldberg, Kenneth Gideon, and Jody Brewster, Partners and Counsel, respectively, Skadden, Arps, Slate, Meagher & Flom, to Pamela F. Olson, Assistant Secretary for Tax Policy, Department of Treasury, and B. John Williams, Chief Counsel, Internal Revenue Service (June 19, 2003) (on file with author and in the public domain). They were, however, presented in a separate communication by the author. *See* Letter from Richard B. Risk, Jr., Attorney and Counselor at Law, Oct. 27, 2003) (on file with author and in the public

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While these factors are not technical tax issues, they certainly bear on whether "needful" guidance is lacking and on the urgency of such guidance.[96] These factors are not offered as an *ad hominem* attack intended to appeal to personal prejudices instead of reason. Deciding the technical tax issue (whether economic benefit attaches) should be done wholly on the merits of the arguments, and the arguments are abundantly clear that economic benefit does not attach to funds transferred to a QSF. However, deciding whether or not to issue guidance is a tax issue—though not a technical one—which must be decided in the context of the Treasury Secretary's duty to act and in consideration of broader public policy established by Congress. A decision not to act is still a decision. All of the ugly factors described here are tax issues because they relate directly to the need for publication of tax treatment guidance.

A. Injury Victims Are Injured Again When Fraud Is Committed on Them

The P&C insurance industry and the brokers who make exclusive "approved broker" deals do so to perpetuate their control over structured settlement transactions. For too long, P&C companies and their brokers have taken the unsupportable position that, as long as the claimant is provided the benefits promised during settlement negotiations, there is no issue if the cost of the periodic payments is less than what was represented due to undisclosed rebating or shopping that takes place after the settlement terms are agreed upon. They appear to have reckoned that because these practices are widespread, they are acceptable.

In two recent decisions, *Lyons v. Medical Malpractice Insurance Association*[97] and *Macomber v. Travelers Property and Casualty Corp.*, courts have come out the other way.[98] In *Macomber*, the Connecticut Supreme Court described this kind of conduct as a "rebating scheme"

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domain).

[96] *See* I.R.C. § 7805(a) (stating that the Secretary "shall prescribe all needful rules and regulations for the enforcement of this title").

[97] 730 N.Y.S.2d 345 (N.Y. App. Div. 2001) (finding privity between settlement parties and remanding for determination of whether insurer's representation of present value constituted fraudulent, intentional or negligent misrepresentation).

[98] 804 A.2d 180 (Conn. 2002) (finding legally cognizable loss from "rebating" and "short changing" schemes); *see also* Matthew Garretson, *A Fine Line We Walk*, 2 ASS'N TRIAL LAWS AM. ANN. CONVENTION REFERENCE MATERIALS: ETHICS IN STRUCTURED SETTLEMENTS 1905 (July 2003) (discussing *Macomber*). Garretson also discusses *Lyons*. *Id.*

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and a "short-changing scheme."[99] The *Macomber* case will no doubt have an effect on structured settlement practices by P&C companies in Connecticut and beyond.

The extent of rebating by structured settlement brokers is unabashedly broad, as the president and CEO of the largest structured settlement brokerage, Robert Blattenburg of Ringler Associates, Inc. stated in a recent letter:

> It is interesting to note that these types of commission sharing or reduced commission agreements are routine in the structured settlement industry. A significant number of the large casualty carriers, self insured's [*sic.*] and insurance agencies have or have had these types of arrangements. Likewise, the majority, if not all of the national structured settlement firms are parties to these types of agreements, including EPS, SFA, Cambridge Galaher, Pension Company, Settlement Planning, American Settlements, Diversified Settlements, Financial Settlements, Brant-Hickey Associates, Settlement Associates, and The Alliance. Last year these firms along with Ringler accounted for in excess of 70% of the structures arranged by independent brokers.[100]

The above letter was written before the Connecticut Supreme Court's *Macomber* decision. No brokerage besides Travelers was a defendant in *Macomber*.

Ringler Associates accounted for approximately $1.6 billion in structured settlement annuity premiums in 2001—nearly twenty-seven percent of the entire $6.12 billion generated in the U.S. by members of NSSTA.[101] Ringler's marketing plan relies heavily on the rebating scheme its president commented on. When a liability insurer or self-insured entity enters an agreement with a brokerage like Ringler, the relationship is called a "national account" or "national program."[102]

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[99] *Macomber*, 804 A.2d at 186.

[100] Letter from Robert J. Blattenberg, President and Chief Executive Officer, Ringler Assocs., to Thomas McCormack, Vice President, National Claims, Chubb & Sons, Inc. (June 25, 2002) (on file with author).

[101] E-mail from Stan Harlan, President, Summit Settlement Services, Re: Survey of standings of industry firms (Mar. 17, 2004) (on file with author); *see also* NSSTA PRESIDENT'S REPORT: "CONTINUED SUCCESS AND GROWTH FOR STRUCTURED SETTLEMENTS" (Apr. 1, 2003), *at* http://www.nssta.com (last visited Feb. 26, 2004) (noting that association members wrote approximately $6.15 billion in premiums in 2002 to cover structured settlement payments).

[102] *See, e.g.*, RINGLER ASSOCS., STRUCTURED SETTLEMENT SERVS. AGREEMENT

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These relationships are monitored centrally and a list showing the amount of the rebate and which other brokerages have relationships with the same entity is provided to each Ringler structured settlement specialist.[103] Brokerages on the list are called "approved brokers." These relationships are designed to prevent a structured settlement specialist engaged by the plaintiff or the plaintiff's attorney from being able to handle the annuity sale transaction.

P&C company and self-insured control over the structured settlement process does not stop with the brokerages. These entities also maintain an "approved market list" of life insurance companies that the P&C company or self-insured defendant will allow to be purchased as the funding asset for a structured settlement. In most cases, the periodic payment liability is transferred by novation to a third-party affiliate of the issuing life insurance company (the assignee), through a section 130 qualified assignment.[104] When this occurs, the injury victim (as ultimate consumer/payee) assumes the risk of assignee default, not the assigning defendant or insurer. This suggests that approved lists of annuity companies are maintained for reasons other than the protection of the defendant or its liability insurer or even for protection of the claimant, to whom the defendant or liability insurer owe no duty.[105] This "approved market list"

(Apr. 17, 1997) (providing for a substantial rebate of Ringler's commission from annuities structured for Prudential and its subsidiaries and affiliates). Typical of such agreements is the *Structured Settlement Services Agreement* dated April 17, 1997, which Ringler entered into with several Prudential entities, calling for a rebate of 1.25% of the premium that will be paid in commissions on the annuity sales. Ringler retains 2.75% of the four percent total commission on the annuity when a Prudential liability insurance case is structured. Four percent is the industry standard for structured settlement annuity commissions.

[103] *See* RINGLER ASSOCS., MASTER LIST OF NAT'L PROGRAM OF MKT. RELATIONSHIPS (excerpt from list on file with author).

[104] *See* I.R.C. § 130.

[105] *See Macomber v. Travelers Prop. and Cas. Corp.*, 804 A.2d 180, 193 n.12 (Conn. 2002). The note states:

> The plaintiffs alleged, specifically, that the defendants acted as the plaintiffs' agents at all times relevant to the settlement of their claims and, as such, owed them a fiduciary duty. We disagree with the plaintiffs' characterization of their relationship with the defendants, and thus look for some other basis upon which to ground their claim for breach of a fiduciary duty.

Id. The note then expands on this finding and suggests that plaintiff control over the annuity purchase would have prevented the wrongdoing alleged:

> After negotiating at arm's length to reach a settlement, the plaintiffs agreed

network is designed to control who gets the annuity premium and who gets the commission.[106] Companies such as CNA, Allstate, Hartford, Liberty, SAFECO, St. Paul, State Farm, Travelers and USAA have announced their intention to recapture damage dollars as annuity premium for their affiliate life insurance companies.[107]

NSSTA had the opportunity to take a stand against rebating when a 1989 study it commissioned from LeBoeuf, Lamb, Leiby & MacRae, L.L.P. (LeBoeuf) warned that certain commission sharing practices practiced by structured settlement brokers possibly violated anti-rebating laws.[108] The LeBoeuf study also noted:

> to accept, and the defendants agreed to provide, part of the total settlement amount in the form of an annuity. Once such an agreement had been reached, the parties' rights and responsibilities were defined by the terms of the settlements alone. Thereunder, the defendants undertook a contractual obligation only to purchase the annuities at a certain cost and with a certain value; the plaintiffs, more importantly, retained no authority over the manner in which the annuities would be procured. Thus, the plaintiffs had no say regarding the type of annuity that would be used to fund their settlements; who would supply the annuity; or the terms under which the annuity was purchased. Indeed, had the plaintiffs been invested with the type of control inherent in the traditional principal-agent relationship, they would have been able to monitor the defendants' conduct and, perhaps, would have been better equipped to safeguard their interests against the rebating and short-changing schemes alleged in the present complaint.

Id.

[106] *See infra* note 108 and accompanying text.

[107] *See* Therese Rutkowski, *Allstate Saves Millions with Six Sigma*, AM. BANKER-BOND BUYER, Apr. 2003, at 16 (discussing Allstate's intention to recapture damage dollars as annuity premium through use of affiliates); Memorandum from Charles W. Harlan, Asst. Vice President, Structured Settlements, CNA, to Ringler Assocs. et al. (Mar. 7, 2003) (discussing funding relationships) (facsimile on file with author) (the author has since learned that CNA Life is being sold, removing the affiliate relationship from CNA P&C); Letter from Kevin A. Mack, Shareholder and Former Officer, Travelers Prop. & Cas. Corp., to Richard Blumenthal, Attorney General, State of Connecticut et al. (Feb. 16, 1998) (alleging improper rebating practices) (copy of letter on file with author); Memorandum from Steve Hatch, Asst. Vice President, Prop. & Cas. Claims, USAA, to Claims Personnel (June 11, 2001) (discussing changes in USAA's structured settlement program intended to leverage internal resources for the benefit of the corporate enterprise) (facsimile on file with author); *see also Macomber*, 804 A.2d at 186 (discussing Travelers' rebating and short-changing schemes).

[108] Memorandum from L. Charles Landgraf, LeBoeuf, Lamb, Leiby & MacRae, to Randy Dyer, Executive Vice President, National Structured Settlements Trade Association, Re: Commission Rebates by Structured Settlement Brokers (May 3, 1989) (copy on file with author).

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> There has been little State enforcement of anti-rebating laws and many insurance departments' failure to apply the anti-rebating laws to 'indirect' rebates may be due more to the subtlety of the transaction and the lack of specific guidance from the courts or State attorneys general on what constitutes an "indirect" rebate, than any conscious policy to permit the practice.
>
> We believe that a program to alert State regulators to the practice could be devised that would result in greater scrutiny of these practices which appear to contravene statutes. However, any such collective activity to enforce these anti-rebating laws raises a number of sensitive issues, not addressed in this memorandum, and we would welcome the opportunity to discuss these with your group.[109]

Instead of alerting state regulators of the need to curb rebating within the structured settlement industry, NSSTA chose to let its members make their own decisions. NSSTA "uncovered all the information that pertained to the matter at hand; it had the information professionally analyzed; and it presented both the raw information and the findings to the membership so they could make informed decisions within their own company on the matter at hand."[110] The result has been the proliferation of rebating throughout the country that we see today.

B. Settlement Funds Provide Choices for Ultimate Consumers

Plaintiffs' advocates argue that it is well settled in common law and in free-market society that the consumer has the ultimate right of choice. In their view, the consumer has the right to select a product from all products available in the marketplace. Along with choice of product, the consumer has the right to choose from whom they will buy. Consumer choice is protected in numerous federal laws, such as the antitrust laws,[111] which indicate a public policy preference to let the free market decide what products get sold.

Insurance laws are adopted by states to protect the consumer.

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[109] *Id.*

[110] *See* E-mail from Randy Dyer, Executive Vice President, NSSTA, to Richard B. Risk, Jr. (Dec. 30, 2002) (on file with author).

[111] *See generally* Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (2003); Clayton Act, 15 U.S.C. §§ 12-27, 29 U.S.C. §§ 52-53 (2003).

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Even though the claimant in a structured settlement will not own the annuity (ownership would cause the loss of tax benefits), when the transaction is complete the annuity company will be making direct periodic payments to the claimant or other payee. In that sense, the claimant is the ultimate consumer. Neither the defendant nor its liability insurer will depend on the product to perform as promised by its issuer, because they are not the consumer. The victim/claimant is the ultimate consumer. The claimant's status as ultimate consumer suggests that he should be able to select the annuity broker. Allowing the claimant to choose the broker would help avoid the abuses and unfair practices that can occur today.

There are any number of reasons for choosing a QSF.[112] While any particular reason could be a valid reason for creating a QSF, the law does not require that there be a reason.[113] Likewise, there is nothing in the Code, legislative history, regulations, or rulings to suggest that a reason is necessary or that the QSF exist for a minimum length of time. The only requirement is that the QSF comply with Treasury Regulations section 1.468B-1(c).[114]

As long as there is no definitive guidance from Treasury and the Service, those whose business plans revolve around controlling the choice of annuity providers can continue to sow seeds of doubt among injury victims, their lawyers, and the courts that adverse tax consequences will result. Definitive guidance should end these campaigns to discredit the use of the QSF in single-claimant scenarios.

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[112] Reasons for choosing a QSF could include: (1) desire to avoid having an adversary handle what may be the largest financial transaction of the injury victim's life; (2) desire to avoid a legal malpractice claim by the claimant against her own attorney for allowing the defense to commit fraud during the settlement process or cause unnecessary adverse tax consequences; (3) desire to select an annuity market from the entire marketplace, taking advantage of free market competition; (4) desire to preserve the option of the claimant to receive tax-free periodic payments, while allowing the defendant(s) to be dismissed; (5) desire to receive funds while preserving the structured settlement option for any and all claimants, and allowing the defendant(s) to be dismissed; (6) desire to receive and hold funds while other matters are being considered, such as the determination of liens and their amounts or the need to establish a supplemental needs trust under 42 U.S.C. § 1396p(d)(4)(A) to preserve Medicaid and Supplemental Security Income (SSI) eligibility; and (7) desire to receive funds for a gravely injured person while the defense's accepted offer is still enforceable, since the death of the claimant changes the circumstances and likely would cause the defense to renegotiate for a reduced amount.

[113] *See* Treas. Reg. § 1.468B-1(c)(2) (1993).

[114] *See id.* § 1.468B-1(c).

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C. "Approved Lists" Enable Companies to Control Annuity Placement and Who Gets Paid

A system of "approved markets" operates ostensibly to protect the liability insurers from defaults by annuity issuers. Yet, starting in 1983, the liability to make future payments as part of a settlement agreement could be transferred to a third-party obligor.[115] This means that the defendant or liability insurer no longer has a legitimate reason (stemming from default concerns) to dictate which annuity company, obligor, or secondary guarantor the claimant selects. Once the periodic payment obligation is assumed by the assignment company, the original obligor is released not only from the original tort liability, which occurs in the settlement agreement, but also from the periodic payment obligation, which is created in the settlement agreement. The only possible recourse the claimant has to the original obligor is for things like misrepresentation of value on which the claimant has relied, or in the case of default, for dictating the choice of annuity markets and guarantors. The claimant assumes all risk once the periodic payment obligation is assigned to the third party.

An example of the approved market list program, typical of most, is the one maintained by Allstate. An internal memo explains it as follows:

> The Structured Claim Settlement process is initiated with a call to a P-CSSO/Encompass approved Broker. Provided with the pertinent case information, the Broker is asked to formulate proposals that address the needs of the Claimant. The proposals provided by the Broker should be quoted with Allstate Life as the annuity issuer. . . .
>
> Although our initial objective is to place the business with Allstate Life, occasionally, a claimant or claimant's representative requests another life insurer be quoted. Reasons for the request could be 1) Claimant and/or attorney preference for a company known to them; 2) Knowledge of a

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[115] *See* Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, 96 Stat. 2605 (1983) (codified at I.R.C. § 104(a)).

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> more competitive price (provided by a plaintiff broker/consultant or a codefendant broker); or 3) Court directive.
>
> When a request of this type occurs due to price considerations, the Broker is required to provide Allstate Life's Structured Settlements Sales Support with a last right of refusal to match the lower cost and to obtain confirmation that this process has been carried out. In most cases, Allstate is able to issue the annuity at the competitive price.
>
> Requests based on Claimant preference are more difficult to resolve. Our efforts are to address the needs of the Claimant. In the limited number of situations in which Allstate Life is not the company of choice, the Broker is required to quote from the following approved insurer list. . . .[116]

When the liability P&C insurer restricts the choice of annuity markets to about seven or eight of the approximately twenty viable and highly-rated companies in the marketplace, chances are good that the claimant loses at least some of the benefits of competition. Annuity issuers on a list of "approved markets" do not need to be as competitive as the rest of the marketplace because the claimant cannot choose a market that is not on the list. This means that markets on the approved list have more opportunity to keep their prices high.

D. Denial of Tax Benefits from a Structure Violates Public Policy

When a settling claimant is presented with a Hobson's choice of periodic payments either from a life insurance company affiliated with the tortfeasor's liability insurer or a cash lump sum (and loss of the subsidy intended by Congress to entice injury victims to elect periodic payments), it is not surprising to see claimants opt for the cash instead of the structure. Denying the opportunity to receive tax-free periodic payments is contrary to public policy, which provides a federal subsidy as encouragement to the victim to elect periodic payments to protect

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[116] Memorandum from John McCulloch, Marketing Manager, Allstate Life Insurance Company Structured Settlements, to Allstate employees, Re: Structured Claim Settlements – Approved Life Insurers (Oct. 19, 2001).

against spendthrift behavior.[117] The practice of limiting a claimant's choice of annuity markets has adversely affected the growth of structures.[118] Structures are good public policy because the use of the qualified settlement fund removes the defendant and its insurer from the damage recovery disbursement decision and increases their acceptance by plaintiffs. By discouraging the use of structures, for profiteering or other reasons, defendants and their insurers are acting in contravention of public policy.

While the actions of P&C companies and their agents is not a technical tax issue, it is a public policy issue with its genesis in a report from the Joint Committee on Taxation. The main thrust of this report was to discuss proposed legislation to initiate a tax on the purchase of future settlement payments. The purpose of the tax benefit intended by Congress was made clear in the following excerpt:

> [I]t can be argued that the choice of the lump sum settlement may create an externality, that is, a cost to taxpayers at large, not borne by the individual who chooses the lump sum settlement. This externality could arise as follows. The amount of damages in a case involving personal physical injuries or physical sickness may be based on the lifetime medical needs of the recipient. If a recipient chooses a lump sum settlement, there is a chance that the individual may, by design or poor luck, mismanage his or her funds so that future medical expenses are not met. If the recipient exhausts his or her funds, the individual may be in the position to receive medical care under Medicaid or in later years under Medicare. That is, the individual may be able to rely on Federally financed medical care in lieu of the medical care that was intended to have been provided by the personal

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[117] *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999), *available at* http://www.house.gov/jct/x-15-99.htm. This document accompanied H.R. 263, 106th Cong. (1999). Code section 5891 was enacted by a subsequent version of that bill, H.R. 2884, 107th Cong. (2002). Generally, section 5891 provides for an excise tax of 40 percent of the "factoring discount" (subsection (a)) on the transfer of the right to receive structured settlement payments, unless the transfer is approved in advance under the authority of an "applicable state statute" (subsection (b)(3)) by an "applicable state court" (subsection (b)(4)), which must consider the "best interest of the payee, taking into account the welfare and support of the payee's dependents" (subsection (b)(2)(A)(ii)). I.R.C. § 5891.

[118] *See* Risk, *supra* note 1, at 903 n.62 (describing the growth of structured settlements from 1976 to 1993).

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> injury award. Such a 'moral hazard' potential may justify a subsidy to encourage the use of a structured settlement arrangement in lieu of a lump sum payment to the recipient, to reduce the probability that such individuals need to make future claims on these government programs. Under the structured settlement arrangement, by contrast to the lump sum, it is argued that because the amount and period of the payments are fixed at the time of the settlement, the payments are more likely to be available in the future to cover anticipated medical expenses . . . .[119]

The benefit referred to as a "subsidy" is intended to provide an incentive for physically injured claimants to accept periodic payments and thus guard against spendthrift behavior that might later make these victims wards of society. Despite Congress's intent to provide victim's with this benefit the threat of lost of tax benefits can be used as leverage to force injury victims into allowing the liability carrier to dictate the selection of the annuity issuer and the structured settlement specialist to receive the commission.

E. The Need for Guidance Has Been Created by Treasury and the Service

The need for additional guidance from Treasury and the Service has been created in part by those agencies. NSSTA has widely distributed a letter referring to a conversation between a representative of an insurance company member of NSSTA and an unnamed person at the Service, indicating that single-claimant QSFs were subject to adverse tax treatment.[120] The author, after contact with officials, has determined and reported that there is tension within the Service on this subject.[121]

Hogan & Hartson, LLP, which serves as general counsel and tax counsel to NSSTA, is in regular communication with and makes frequent visits to staff attorneys at Treasury and the Service. Based on these communications, the firm has reported to the NSSTA membership on numerous occasions its conclusion that there is a risk of adverse tax treatment when a qualified assignment is made from a

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[119] *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999), *available at* http://www.house.gov/jct/x-15-99.htm; *see also supra* note 54 and accompanying text.

[120] *See* Risk, *supra* note 1, at 896.

[121] *See id.* at 896 n.156.

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QSF created for a single claimant or when there has been a prior allocation of the funds to be transferred. For example, Hogan & Hartson attorney William L. Neff said in his written remarks, *Ability of Section 468B funds to Make Section 130 Assignments*, to the NSSTA 1997 Annual Meeting:

> The IRS is aware that single party and related party section 468B funds are being implemented. It is the view of certain IRS officials that section 468B does not override the general rules on constructive receipt and economic benefit. If constructive receipt and economic benefit rules apply, there could be no section 130 assignment from a one-person section 468B trust. The funding of the 468B trust and the elimination of all possible claims against the trust other than the single claimant would cause that claimant to have the economic benefit of the funds in the trust.
>
> In the view of these officials the purpose of section 468B was to deal with the problem of "homeless" income, i.e. income on accounts, escrows and other funds that all parties treated as attributable to some other party. Section 468B provides that the account, escrow, fund or trust is itself a taxable entity. The statement in the regulations that a section 468B trust is a trust is established [*sic.*] "to resolve or satisfy one or more contested or uncontested claims" is a part of the definition of a "qualified settlement fund" and nothing more. That the "one or more" phrase is repeated in Revenue Procedure [93-34][122] authorizing qualified assignments from qualified settlement funds again in only part of the definition of a qualified settlement fund under section 468B. Just because the fund is a section 468B fund does not mean that every assignment of a settlement of a section 104(a)(2) claim will qualify under section 130.
>
> *These same IRS officials acknowledge that other IRS officials may have the view* that the regulations under section 468B, as applied in Revenue Procedure [93-34], do amount to an overruling of the general rules of constructive receipt and economic benefit to some extent, at least if there is more than

[122] Neff consistently referred to Rev. Proc. 93-64 in his printed text. He meant Rev. Proc. 93-34, and I have made that correction throughout his text.

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> one claimant. Under the rules of economic benefit, a third party assuming the liability to make payments to a claimant would be treated as the receipt of the present value of all future payments by the claimant. Congress clearly could not have intended this result or section 130 would not work in any circumstances. It follows that Congress must have intended to overrule these general rules when applied to section 130 qualified assignments despite the explicit statement in the legislative history to the contrary. If the general rules of constructive receipt and economic benefit do not apply to section 130 qualified assignments, in general, *these other officials conclude* that constructive receipt and economic benefit do not necessarily apply to section 130 qualified assignments from section 468B funds particularly in light of the "one or more" language in the regulations and Revenue Procedure [93-34].[123]

It is significant to this discussion that Neff reported an internal division of opinion among Service staff members as to the answer to this question. This is disturbing news to physical injury victims and their attorneys who desire to have settlement damage recovery funds paid into a QSF.

Neff's presentation to the NSSTA annual meeting obviously meant to discourage the use of QSFs in single-claimant cases. He concludes that, "it is my opinion that single claimant section 468B funds cannot do qualified assignments."[124] Neff bases his conclusion on the concept of economic benefit, arguing that the claimant would be treated as having received the amount transferred to the QSF because "the claimant will get everything—there is no one else."[125] But, as I have pointed out, the Service reached the opposite conclusion in Revenue Ruling 79-220, when it held that there was no constructive receipt or economic benefit in a structured settlement where the obligor held a funding asset exclusively for a single payee, but the payee had rights only to the periodic payments.[126] Congress specifically agreed with the Service in the House and Senate reports

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[123] William L. Neff, Ability of Section 468B Funds to Make Section 130 Assignments, Address to the National Structured Settlements Trade Association Annual Meeting (May 7-11, 1997) (emphasis added) (transcript on file with author) [hereinafter Neff 1997 Address].

[124] *Id.*

[125] *Id.*

[126] *See* Rev. Rul. 79-220, 1979-2 C.B. 74.

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accompanying the Periodic Payment of Judgments Tax Act of 1982, stating that it did not intend to change existing law, only to codify it.[127] The reports cited Revenue Ruling 79-220 as one of three rulings integral to existing law, noting specifically that constructive receipt and economic benefit did not apply.[128] Payment into a section 468B fund (QSF) provides an additional layer of separation between the fund and the claimant, because the claimant is not even a payee until the fund settles with the claimant.

Neff's analysis is similarly flawed in his discussion of a section 468B fund that is created for the benefit of multiple claimants. He says:

> I believe the real tax concern for "qualified assignments" from a section 468B fund involving related parties is that the parties would have agreed in advance of the funding of the section 468B fund on the share of each of the parties. If there is an agreement among the claimants as to shares, that agreement may become an enforceable agreement on the funding of the section 468B fund and the release of the defendant and defendant's insurer. If there is such an agreement, claimants would have received an economic benefit on the funding of the section 468B fund and a qualified assignment could not be made by the section 468B fund.
>
> . . .
>
> In a challenge to an assignment from a section 468B fund, the IRS and the courts would consider all surrounding facts and circumstances to determine if an enforceable agreement as to shares in the settlement was in place prior to the purported "qualified assignment." One fact that could be given considerable weight would be the period of time between funding the section 468B fund, the resolution of each parties' claims against the fund and the "qualified assignment." If the period is short, for example, all taking place over the space of a few hours, it seems probable that the parties have already agreed as the shares of the settlement. Section 468B funds

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[127] H.R. REP. NO. 97-832, pt. II, at n.2 & Explanation of Provisions (1982).

[128] *Id.*

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> frequently have elaborate procedures for resolving claims against the funds spelling out notice procedures, factors considered, hearing rights, and appeal rights. The absence of such procedures would indicate the procedures were unnecessary because there were no disputes to resolve.[129]

The fallacy of these arguments is that they all depend on the theory that there can be no allocation of the damage recovery amount among the claimants prior to the QSF being funded. If there is an allocation, under this theory the individual has the economic benefit of her portion of the damage recovery. This reasoning omits the fact that, in every case, before distribution can occur, there must be an allocation. Whether that allocation occurs before the QSF is established or seconds before disbursement of the funds, under this theory economic benefit triggers and there can be no qualified assignment from the QSF. Therefore, even when a QSF is established for the benefit of multiple claimants, economic benefit will always occur. Congress obviously did not intend this result.

In a February 2001 memorandum to the NSSTA board, Neff again reported on recent contacts he had made with the Service to determine the status of pending matters relating to section 468B.[130] Again, his report illustrates significant internal tension over whether a qualified assignment may be made from a QSF created for the benefit of a single claimant. The message to the structured settlement community and the general public is still very unsettling. Apparently nobody within Treasury or the Service knows what the outcome of a ruling on this matter would be. Neff wrote:

> The responses of the IRS staff to my inquiries made it clear that the staff already had a high degree of familiarity with the use of section 468B trusts in connection with structured settlements. They were aware that section 468B trusts had been used in connection with structured settlements in single plaintiff tort cases and advised me that *there may be no consensus* regarding the use of section 468B trusts in connection with structured settlements that involve a single plaintiff.

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[129] *See* Neff 1997 Address, *supra* note 123.

[130] Memorandum from William L. Neff, Hogan & Hartson, LLP, to NSSTA Board of Directors (Feb. 21, 2001) (on file with author).

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> The informal view expressed in the IRS branch was that section 468B deals with the issue of "homeless" income during the pendency of litigation, after a fund has been created. The reference to "one or more claims" in the Treasury Regulations under section 468B and in the revenue procedure is definitional regarding what is covered by section 468B. The reference to "one or more claims" is not viewed as having any interpretive bearing on constructive receipt or economic benefit issues that might arise in conjunction with section 130 qualified assignments of structured settlements involving section 468B trusts. The IRS staff volunteered that the issues of constructive receipt and economic benefit are more complicated if there are multiple claimants with derivative claims and if minors are involved.
>
> These individuals also noted that they were aware that section 468B trusts which had very limited period of existence were being used in tort cases. They suggested that this may not be consistent with the legislative purpose of section 468B which was to deal with the taxation of "homeless" income after a claim was funded but before the damages were distributed.
>
> The individuals at the IRS stated that they understood that *some individuals, particularly at Treasury, may have a more expansive view of the scope of section 468B in tort cases.* They have heard it suggested that the "one or more claims" language may be sufficient to override normal constructive receipt and economic benefit rules to allow assignments in single plaintiff cases using section 468B trusts. Particularly considering the change in personnel that is likely to occur in connection with the change of administration, *the individuals at the IRS would not hazard a guess as to the "governmental" position* on the application of section 468B to single plaintiff section 130 assignments.[131]

Others in the industry appear to be using Treasury's inaction to their benefit. For example, John McCulloch, Director of Structured Settlements for Allstate Life Insurance Company, gave a presentation

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[131] *Id.* (emphasis added).

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called *Qualified Settlement Funds (468B)* to the regional meeting of the NSSTA held in January 2004 in Los Angeles. His presentation recounted many of the usual arguments against the use of single-claimant QSFs to make qualified assignments.[132] After defending his company's position, McCulloch concluded that "[w]ith the posture of Treasury at question and the issue unresolved, we choose to wait for clarity from Treasury."[133]

This conflicts with the actions of Steven Boger, former vice president for structured settlements at Allstate,[134] who wrote a letter to Treasury and Service officials dated July 24, 2003, while serving as president of the NSSTA. Boger's letter opposed the need for written guidance on qualified assignments from single-claimant QSFs.[135] He offered the history of Revenue Procedure 93-34, which he said was published at the instigation of NSSTA in 1993 and which did not request guidance for single-claimant cases. Boger said:

> In the individual tort claimant situation, there was no such need for guidance because the defendant (or its liability carrier) making the section 130 qualified assignment clearly was "a party to the suit or agreement" under Code section 130(c)(1) and hence the claimant in an individual tort situation clearly could avail himself or herself of the section 130 periodic payment mechanism already. Therefore, Rev. Proc. 93-34 was not intended to address the situation of a single claimant.[136]

Boger subsequently led a delegation from NSSTA to meet in late September 2003 with Treasury and Service officials, presumably to lobby against the issuance of formal guidance.[137] Boger's efforts to

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[132] John McCulloch, Allstate Financial, *Qualified Settlement Funds (468B)* (PowerPoint™ presentation obtained by the author from "Members Only" section of National Structured Settlements Trade Association web site).

[133] *Id.*

[134] Boger departed Allstate in late 2003, before his term as president of the NSSTA ended, causing him to resign that post.

[135] Letter from Steve Boger, President, NSSTA, to Pamela F. Olson, Assistant Secretary (Tax Policy), Department of the Treasury, Emily A. Parker, Acting Chief Counsel, Internal Revenue Service, and several "cc" addressees at Treasury or the Service: Eric Solomon, Helen Hubbard, Gary Wilcox, Robert Brown, Tom Luxner and Mike Montemurro (July 24, 2003) (on file with author).

[136] *Id.*

[137] Boger sent a memo dated October 2, 2003, to NSSTA members, "Report on 468B Meeting at Treasury," confirming essentially that they had discussed the topics

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persuade Treasury and the Service not to issue guidance on the single-claimant QSF combined with McCulloch's statement that Allstate is waiting "for clarity from Treasury" to ring hollow.[138] Industry seems to prefer avoidance of definitive answers to the tax treatment questions raised by McCulloch in his January 2004 presentation to NSSTA. Others have joined in the campaign to create doubt over the viability of single-claimant QSFs. Frank A. Pension is owner of The Pension Company, and a longtime structured settlement broker and staunch advocate of defense control over the structured settlement process. Pension, who is not an attorney, gave an affidavit that was filed with the court in a case in which the proposed use of a QSF would remove his company entirely from the settlement process. The defendant or its insurer, Pension's client, had agreed to pay $1.85 million for the benefit of the claimant, part of which was due to be structured. He attached, as supporting documentation, both the above-cited Neff memorandum to the NSSTA Board of Directors and a copy of Neff's presentation to the NSSTA Annual Meeting.[139] Pension's statement reads, in part:

> The plaintiff in this case proposes to utilize a 468B Trust, though it involves only an individual claim [Emphasis in original.] against the defendants. Arbitrarily citing only the "one or more" language associated with Revenue Procedure 93-34 and the Treasury Regulations associated with § 468B of the Code, the plaintiff not only contends that a § 468B Trust can be created to fund a tax-free structured settlement in this case outside a class action scenario, but also suggests ignoring the other applicable tax law principles of constructive receipt and economic benefit. This is arguably an abuse of the 468B status and could destroy the tax-free aspect of all the future periodic payments to the infant, Alfonse D. Scinta. Neither the IRS nor the Treasury Department have issued any rulings

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in his July 24, 2003, letter.

[138] *See supra* notes 134-35 and accompanying text.

[139] Mr. Neff's presentation to the 1997 NSSTA Annual Meeting is also discussed elsewhere in this article. *See* Neff 1997 Address, *supra* note 123 and accompanying text. Mr. Pension also included a bulletin, Structured Settlement Update, Winter 1996, "Questions and Answers About Section 468B – Qualified Settlement Funds," by David M. Higgins, then a partner at Brobeck, Phleger & Harrison, LLP, Los Angeles. Mr. Higgins, who is the acknowledged drafter of the Periodic Payment Settlement Tax Act of 1982, has since recanted his earlier position on the risk associated with single-claimant QSFs and much of his tax law practice involves the creation and administration of single-claimant QSFs.

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> or regulations that creating a structured settlement from a 468B settlement fund under the circumstances involved here for a single claimant or a family unit with no real adverse economic interests would receive tax-free status. To the contrary, it seems more probable that this transaction would trigger severe adverse tax consequences to the infant, Alfonse D. Scinta.[140]

McCulloch's presentation follows a request for clarification by some very knowledgeable tax practitioners at Skadden, Arps, Slate, Meagher & Flom, LLP. Members of that firm submitted a letter dated June 19, 2003 requesting that the Service and Treasury publish guidance for section 130.[141] This letter requested clarification that assignment of a liability to make periodic payments does not fail to be a "qualified assignment" for purposes of section 130 solely because the settlement proceeds are held temporarily in a qualified settlement fund, as defined in Treasury Regulations section 1.468B-1(c), before the periodic payment liability is assigned.[142] The letter and its attachments recommended an amendment to Revenue Procedure 93-34 and suggested text that would modify and supercede that Revenue Procedure to make clear that a QSF may make a qualified assignment under section 130 in single claimant cases.[143]

The industry is using reports of conflict within the Treasury to maintain the status quo. Since the apparent confusion is being used to contravene public policy, Treasury itself is creating the need for clarification. Treasury needs to issue written guidance.

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[140] Affidavit by Frank A. Pension for Defendant Kathleen J. VanCoevering, Scinta v. VanCoevering, 726 N.Y.S.2d 520 (N.Y. App. Div. 2001) (No. I 1994/7829) (May 22, 2001) (parenthetical references omitted).

[141] Fred Goldberg et al., *Attorneys Urge Treasury to Publish Guidance on Personal Liability Assignments*, TAX NOTES TODAY (July 3, 2003) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2003 TNT 128-24). The tax credentials of the Skadden Arps letter signatories are stellar. Fred Goldberg served as chief counsel of the Service from 1984 to 1986, as commissioner of the Service from 1989 to 1992, and as assistant secretary of the Treasury for tax policy during 1992. Kenneth Gideon served as chief counsel of the Service from 1981 through 1983 and as assistant secretary of the Treasury for tax policy from 1989 to 1992. They were both in key policymaking positions at the time Treasury Regulations section 1.468B and Revenue Procedure 93-34 were being developed. Jody Brewster is also formerly with the Service, and her name appears on several key rulings affecting structured settlements.

[142] *Id.*

[143] Rev. Proc. 93-94, 1993-2 C.B. 470.

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IV. CONCLUSION

The Secretary has the power to issue rules and regulations, and "shall prescribe all needful rules and regulations."[144] Treasury Regulations section 1.468B and Revenue Procedure 93-34, which both became effective in 1993, do not adequately provide all "needful" guidance for the promulgation and enforcement of Code section 468B, which was enacted as part of the Tax Reform of 1986 and amended under the Technical and Miscellaneous Revenue Act of 1988.

Victims and their families are being injured by P&C companies and their "approved list" structured settlement specialists. This behavior contravenes public policy. The "subsidy" of tax-free growth being made available to physical injury or sickness victims in tort claims, a public policy intended by Congress,[145] is wrongfully being withheld by self-insured entities and P&C insurance companies, their claim adjusters, the attorneys they hire to defend their insured tortfeasors, and approved brokers who have agency relationships with the insurers. This withholding of the subsidy is done to force injury victims to allow the defense to dictate who will issue the annuity and who will receive the commission.

The majority of this behavior would be averted through widespread use of QSFs, whether for multiple claimants or single claimants. The structured settlement industry in its current formulation is actively conducting a campaign to maintain the status quo by planting seeds of doubt in the minds of injury victims and their attorneys that the victims are at risk for adverse tax consequences if a QSF is used. The big players in today's structured settlement industry do not want written guidance on this issue because, without it, they can continue business as usual.

This conduct takes place against a backdrop of government indecision. Treasury and the Service cannot agree internally on

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[144] I.R.C. § 7805(a). The section states in full:

> Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

Id.

[145] *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999), *available at* http://www.house.gov/jct/x-15-99.htm.

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whether a QSF created for the benefit of a single-claimant can make a section 130 qualified assignment. This paralyzes the process of private rulings, since non-binding private rulings are rendered by non-policymaking staff attorneys who reportedly are in disagreement with the policy makers and among themselves. The fact that this intra-agency tension has been made public creates even more doubt as to the risk of adverse tax consequences. As a result, the possibility of adverse tax consequences looms when a QSF is used not just in single-claimant cases, but in other cases where the claimants are related and the allocation process is not arm's-length.

The public deserves clear guidance from the government on how the Code will be administered and enforced, particularly since more than $6 billion annually is at issue.[146] The case for priority on interpretation of this issue is even stronger when one considers the protracted period that has elapsed from the time the law was enacted in 1986 to the present. The Secretary of the Treasury has a duty to decide the policy question and promulgate an outcome without further delay.

The technical tax arguments are persuasive—economic benefit does not attach to assets of a QSF while they are being held temporarily for further distribution. Despite the strength of the case for the position that economic benefit does not attach to such assets, the evidence of internal tension at Treasury and the Service on this issue makes a compelling argument that immediate issuance of "needful" guidance is called for. For political reasons, however, Treasury and the Service may decide not to act. If there is a decision not to act on the request for published guidance, taxpayers who have suffered physical injuries or sickness through the negligence of others will continue to be victimized by the structured settlement industry. Or, they might opt to forego their considerable tax benefits. Either way, the public loses.

[146] Press Release, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003), *available at* http://www.nssta.com.

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June 19, 2003

Pamela F. Olson
Assistant Secretary (Tax Policy)
Department of Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

B. John Williams
Chief Counsel, Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Section 130 Qualified Assignments

Dear Assistant Secretary Olson and Chief Counsel Williams:

We respectfully request that the Internal Revenue Service ("IRS") and Treasury Department ("Treasury") publish guidance under section 130 of the Internal Revenue Code (the "Code").[1] In general, section 130 provides that, in the case of a "qualified assignment" of a liability to make periodic payments of damages on account of personal injury, the assignee may exclude from gross income the amount it receives for assuming the liability to the extent assets are acquired to fund the periodic payments. We request guidance clarifying that the assignment of a liability to make periodic payments does not fail to be a "qualified assignment" for purposes of section 130 solely because the settlement proceeds are held temporarily in a qualified settlement fund (as defined in Treas. Reg. § 1.468B-1(c)) before the liability is assigned.

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[1] Unless otherwise indicated, all section references are to the Code.

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The failure of a number of insurance companies and the financial weakness of others have led to concerns about the safety, security and long-term viability of traditional annuity-based structured settlements. These concerns have resulted in the use of qualified settlement funds in many structured settlements today to ensure that the assets needed to fund the future periodic payments to the claimant will be secure.

We understand the IRS currently is considering whether, in a situation where the settlement involves a single claimant and a qualified settlement fund to facilitate assignment of the liability to make periodic payments to the claimant, the judicial economic benefit doctrine may somehow apply to cause the assignment to fail to be a qualified assignment under section 130. We believe that application of the economic benefit doctrine to disqualify an otherwise qualified assignment would be contrary to section 130, Congress' intent in enacting the 1988 statutory amendment, and the policy underlying Rev. Proc. 93-34, 1993-2 C.B. 470, which provides procedures under which qualified settlement funds can be used to facilitate a qualified assignment under section 130. Application of the economic benefit doctrine to qualified settlement funds used to facilitate qualified assignments would as a practical matter render Rev. Proc. 93-34 a nullity. Because this issue impacts a substantial number of structured settlements involving an assignment of the liability to make periodic payments, we believe the issue should be addressed in published guidance.

Attached for your convenience is a memorandum that describes structured settlements involving the assignment of a liability to make periodic payments to a claimant and discusses the tax consequences of such settlements. Also attached is a proposed revenue procedure that we believe would provide the requested clarification. The proposed revenue procedure would modify and supercede Rev. Proc. 93-34 to make clear that a qualified settlement fund may make a qualified assignment under section 130 in a case involving a single claimant. For your convenience, we have also attached a blackline comparing the proposed revenue procedure to Rev. Proc. 93-34.

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We would appreciate the opportunity to discuss this issue with you and others from the IRS and Treasury. If you have any questions or would like additional information, please call Fred Goldberg at (202) 371-7110, Ken Gideon at (202) 371-7540, or Jody Brewster at (202) 371-7238.

Sincerely,

Fred Goldberg

Kenneth Gideon

Jody Brewster

cc: Eric Solomon
Helen Hubbard
Gary Wilcox
Robert Brown
Tom Luxner
Mike Montemurro

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Tax Consequences of a Single-Claimant Qualified Settlement Fund Used to Facilitate a Qualified Assignment under Section 130 of the Code

The failure of a number of insurance companies and the financial weakness of others have led to concerns among settling claimants about the safety, security and long-term viability of traditional annuity-based structured settlements. These concerns have resulted in the use of a qualified settlement fund as defined in Treas. Reg. § 1.468B-1(c) ("QSF")[1] to structure many settlements today to ensure that the annuities used to fund the periodic payments to a claimant will be safe, secure and viable.[2] Some defendants and their insurers have suggested that the economic benefit doctrine prevents a QSF from making a "qualified assignment" under section 130 of the Internal Revenue Code (the "Code"), particularly in settlements involving a single claimant, but also in multiple-claimant settlements where the amount paid to the QSF by the defendant or its insurer has been pre-allocated among the claimants.

This document (1) provides general background regarding the tax consequences of structured settlements; (2) describes variations of structured settlements that involve a single claimant, an assignment of the liability to make periodic payments to the claimant, and the use of a QSF; and (3) analyzes the impact, if any, of the economic benefit doctrine on an otherwise "qualified assignment" as defined in section 130(c) of the Code.

In summary, application of the economic benefit doctrine to prevent a qualified assignment by a QSF under section 130 would be contrary to the clear statutory override of that judicial doctrine in section 130, Congress intent underlying the 1988 amendment to section 130, and the policy underlying Rev. Proc. 93-34, 1993-2 C.B. 470. Given the uncertainty that exists in negotiations of structured settlements, Treasury and the IRS should publish guidance clarifying that the

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1 A small number of structured settlements use a "designated settlement fund" as defined in section 468B(d)(2) of the Code ("DSF"), rather than a QSF. QSFs generally are preferred because the QSF regulations provide more complete guidance for taxpayers than does the statute providing for DSFs. For the sake of convenience, this document addresses only QSFs. However, the same issues and legal principles apply in the case of DSFs as well.

2 Additional considerations that result in the use of a QSF include (1) ensuring that the distribution of settlement proceeds, including periodic payments, is designed to meet the needs of the claimant; (2) ensuring that the claimant has the full benefit of a competitive free market for funding assets; and (3) ensuring that settlement proceeds are transferred at a time when the defendant or the defendant's insurer is solvent and funds are available.

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economic benefit doctrine does not apply to prevent a QSF from making a qualified assignment under section 130. The attached draft revenue procedure, which would modify and supercede Rev. Proc. 93-34, contains the type of guidance that would provide the necessary clarification.

Background

Sections 104, 130, and 468B of the Code and the regulations thereunder interact to provide claimants, defendants and their insurers a great deal of flexibility in structuring the settlements of actions arising from personal physical injuries (*e.g.*, an automobile accident, a plane crash, medical malpractice, or a defective product). Under section 104(a)(2), gross income does not include "the amount of any damages (other than punitive damages) received . . . on account of personal physical injuries or physical sickness." The exclusion from gross income under section 104(a)(2) applies without regard to whether the damages are received pursuant to a lawsuit or a settlement agreement. Section 104(a)(2) (parenthetical language). Thus, if a defendant makes a single, lump-sum settlement payment of damages to the claimant, the lump-sum payment is excluded from the claimant's gross income pursuant to section 104(a)(2). Any future earnings on that lump-sum amount, however, will be taxable to the claimant.

The claimant may reject a lump-sum settlement payment because such a payment does not meet the future needs, for example, of a minor, incompetent, unsophisticated or severely-injured claimant. Instead, the claimant may insist upon periodic payments. The exclusion from gross income under section 104(a)(2) applies without regard to whether the amounts are received in a single lump sum or as periodic payments. Section 104(a)(2) (parenthetical language). Thus, if a defendant agrees to make periodic settlement payments to the claimant, each of the periodic payments received by the claimant is excludable from the claimant's gross income under section 104(a)(2), including the portion of the payments that can be traced to income earned on assets that may have been set aside to fund the periodic payments.

Where a claimant wants to receive periodic payments, but the defendant wants to make a lump-sum payment, a settlement can be structured requiring the defendant to make periodic payments, and the defendant can in turn make a "qualified assignment" pursuant to section 130 of that periodic-payment liability to a third-party (the "assignee") together with the lump-sum payment. Typically, the assignee is an affiliate of an insurance company, and its only business is to accept for a fee qualified assignments of liabilities to make periodic payments to

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tort claimants. Section 130 sets forth rules that apply to a "qualified assignment" of a defendant's or its insurer's liability to make periodic payments to a claimant. Absent section 130, the lump-sum payment received by the assignee would be income to the assignee in the year received, and the assignee would get a deduction for the periodic payments – but only as the payments are made to the claimant. In contrast, if section 130 applies (*i.e.*, because the assignment is a "qualified assignment" as defined in section 130(c)[3]), the lump-sum payment is excluded from the assignee's gross income to the extent the payment received by the assignee does not exceed the assignee's cost of the "qualified funding assets" (Treasury obligations or annuities) acquired by the assignee to fund the periodic payments. In other words, the assignee includes in income only that portion of the lump-sum payment that is not used to purchase qualified funding assets.

Section 130 was added to the Code by the Periodic Payment Act of 1982, Pub. L. 97-473, 96 Stat. 2605, which also amended section 104(a)(2) to exclude from a claimant's gross income any damages received as periodic payments on account of personal injuries. The legislative history to the Periodic Payment Settlement Act of 1982 explains that section 104(a)(2) was amended and section 130 was added to the Code to provide statutory certainty that periodic payments of personal injury damages are excludable from the gross income of the recipient, and that likewise, amounts received by an assignee are excludable from the gross income

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[3] Section 130(c) defines a "qualified assignment" as:

any assignment of a liability to make periodic payments as damages (whether by suit or agreement), or as compensation under any workmen's compensation act, on account of personal injury or sickness (in a case involving physical injury or physical sickness) –

(1) if the assignee assumes such liability from a person who is a party to the suit or agreement, or the workmen's compensation claim, and

(2) if —

(A) such periodic payments are fixed and determinable as to amount and time of payment,

(B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments,

(C) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and

(D) such periodic payments are excludable from the gross income of the recipient under paragraph (1) or (2) of section 104(a).

The determination for purposes of this chapter of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor.

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of the assignee to the extent that those amounts are used to purchase annuities or Treasury obligations to fund the periodic payment liability. S. REP. NO. 97-646, 97th Cong., 2d Sess. 4 (1982). The public policy of encouraging structured settlements has been reaffirmed in subsequent legislation.[4]

The interests of a defendant's insurer may also impact settlement negotiations. The defendant's insurer may seek to settle a lawsuit by paying the claimant in periodic payments funded by an annuity from an affiliated life insurance company (or from another company selected by the defendant's insurer). The claimant may reject periodic payments funded by the insurer's affiliated or selected life insurance company because of concerns about its safety, security, and long-term viability.

A settlement between parties with such diverse objectives can be structured using a QSF. A QSF is any fund, account, or trust if—

> (1) it is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

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4 See Joint Committee on Taxation, Tax Treatment of Structured Settlement Arrangements, JCX-15-99 (Mar. 16, 1999), which describes the "public policy interest in tax subsidy for structured settlement arrangements" as follows:

> The amount of damages in a case involving personal physical injuries or physical sickness may be based on the lifetime medical needs of the recipient. If a recipient chooses a lump sum settlement, there is a chance that the individual may, by design or poor luck, mismanage his or her funds so that future medical expenses are not met. If the recipient exhausts his or her funds, the individual may be in the position to receive medical care under Medicaid or in later years under Medicare. That is, the individual may be able to rely on Federally financed medical care in lieu of the medical care that was intended to have been provided by the personal injury award. Such a "moral hazard" potential may justify a subsidy to encourage the use of a structured settlement arrangement in lieu of a lump sum payment to the recipient, to reduce the probability that such individuals need to make future claims on these government programs.

JCX 15-99 accompanied H.R. 263, "The Structured Settlement Protection Act," 106th Cong., 1st Sess. Section 5891 of the Code was enacted by a subsequent version of that bill, H.R. 2884, on January 23, 2002. Generally, Section 5891 provides for an excise tax on the transfer of the right to receive structured settlement payments.

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(2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability under CERCLA, arising out of a tort, breach of contract, or violation of law, or designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

Treas. Reg. § 1.468B-1(c).

In a structured settlement involving a QSF, the defendant or its insurer transfers its settlement payment to the QSF and is released and dismissed from the suit.[5] The QSF then uses the lump-sum payment from the defendant or its insurer to settle the claims of the claimant against the QSF. Pursuant to the settlement agreement between the QSF and the claimant, the QSF agrees to make periodic payments to the claimant and assigns that liability to an assignee in a qualified assignment acceptable to the claimant. The assignee purchases qualified funding assets to fund the periodic payments. A QSF can make a "qualified assignment" under section 130 of the QSF's liability to make periodic payments to a claimant. *See* Rev. Proc. 93-34, 1993-2 C.B. 470. That is, where a defendant transfers its settlement payment to a QSF, and the QSF agrees to make periodic payments to the claimant, the QSF may subsequently assign that liability in a qualified assignment. Under Rev. Proc. 93-34, the QSF is treated as "a party to the suit or agreement" for purposes of section 130(c)(1).

The Economic Benefit Issue

Under the doctrine of economic benefit, a taxpayer is considered in actual receipt of income when assets are unconditionally and irrevocably paid into a fund or trust to be used for the taxpayer's sole economic benefit. *See Sproull v. Comm'r*, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952) (employee received current income in the form of amounts irrevocably paid out by

5 Treas. Reg. § 1.468B-3(c) provides that, for purposes of section 461(h), "economic performance" occurs when and to the extent that the defendant makes a transfer to a QSF to resolve or satisfy its tort liability. Absent this special rule, section 461(h)(2)(c) would defer the defendant's deduction until the QSF paid the amount to the claimant.

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employer to a trust for the sole benefit of the employee). Where a QSF makes a qualified assignment under Rev. Proc. 93-34 in a settlement involving a single claimant, two arguments based on the economic benefit doctrine have been suggested by defendants and their insurers to prevent qualification as a "qualified assignment" under section 130(c).

First, it has been suggested that there can be no qualified assignment because the future periodic payments would not be excludable from the claimant's gross income under section 104(a)(1) or (2), as required by section 130(c)(2)(D). That is, if the claimant were considered, by application of the economic benefit doctrine, to have received the defendant's settlement payment at the time that payment was transferred to the QSF, then only that payment would be excludable from the claimant's gross income under section 104(a)(2). Future periodic payments would not be excludable under section 104(a)(1) or (2) as required by section 130(c)(2)(D). Thus, the assignment would fail to qualify as a "qualified assignment."

Second, it has been suggested that there can be no qualified assignment because the assignee has not assumed a liability from a person who is "a party to the suit or agreement" as required by section 130(c)(1). Rev. Proc. 93-34 provides that, if certain requirements are satisfied, a QSF will be treated as a party to the suit or agreement. In the case of a QSF, a "transferor" is a person that transfers money or property to the QSF to resolve or satisfy claims against that person. Treas. Reg. § 1.468B-1(d)(1). Arguably, if a claimant were considered by reason of the economic benefit doctrine to have received the settlement proceeds at the time the proceeds were transferred to a settlement fund, then it would follow that the transferor of the settlement proceeds to the settlement fund would be the claimant, rather than the defendant. If so, the settlement fund arguably would not be a QSF treated as "a party to the suit or agreement" under Rev. Proc. 93-34, and thus, the assignment would not be a "qualified assignment."

Discussion

The economic benefit doctrine does not apply to disqualify an otherwise qualified assignment under section 130. Any other conclusion would be contrary to the statutory language of section 130, the Congressional intent underlying the 1988 amendment to the statute, Rev. Proc. 93-34, and the policy underlying Rev. Proc. 93-34.

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Section 130 and Congress' Intent Underlying the 1988 Amendment

Section 130 expressly provides that the "determination for purposes of this chapter of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor." Section 130(c) (flush language). It is clear from the context in which this statutory language arose that Congress intended this language to preclude application of the economic benefit doctrine to cause an otherwise "qualified assignment" to fail to be a "qualified assignment" for purposes of section 130.

As initially enacted, section 130 restricted the rights that a claimant could have against the assignee and in the assets used to fund the future periodic payments. Specifically, section 130(c)(2)(C) (repealed in 1988) required that "the assignee does not provide to the recipient of such payment rights against the assignee which are greater than those of a general creditor." The legislative history explained that the periodic payments of personal injury damages are "excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the *current economic benefit* of the sum required to produce the periodic payments." S. REP. NO. 97-646; H.R. REP. NO. 97-832, 97th Cong., 2d Sess. 4 (1982) (emphasis added). Congress later abandoned this "general creditor" restriction.

In 1988, Congress repealed section 130(c)(2)(C), because, in Congress' view, "[r]ecipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of the tax law." H.R. REP. NO. 100-795, at 541 (1988). Congress also added the flush language to section 130(c) to provide that the determination of "when the recipient of periodic payments *is treated as having received any payment* with respect to which there has been a qualified assignment shall be made without regard to any provision of the assignment which grants the recipient rights as a creditor greater than those of a general creditor." Section 6079(b)(1)(A) of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (emphasis added). The legislative history to the 1988 statutory amendment explains that "no amount *is currently includible in the recipient's income* solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor." H.R. CONF. REP. NO. 1104, 100th Cong., 2d Sess. at II-171(1988) (emphasis added). The concepts addressed in the 1988 statutory amendment and its legislative history of "treating a payment as having been received" and "as currently includible in income"

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are economic benefit concepts. Congress' intent was to make clear that these economic benefit concepts do not apply in determining whether there is a qualified assignment for purposes of section 130.

The IRS has interpreted the 1988 amendment to section 130(c) as intended to allow assignments of periodic payment liabilities without regard to whether a claimant has the current economic benefit of the settlement proceeds or the funding assets purchased with those settlement proceeds. In PLR 9703038 (Jan. 17, 1997),[6] a defendant assigned to a trust the defendant's liability to make future periodic payments to the claimant. The trustee used the settlement proceeds it received from the defendant to purchase funding assets and gave the claimant a security interest in the funding assets. The IRS ruled that, assuming all other requirements of section 130(c) were met, the defendant's assignment to the trust of the defendant's liability to make future periodic payments to the claimant was a qualified assignment. In so ruling, the IRS concluded that, although the setting aside of funds in trust for a claimant generally confers an economic benefit to the claimant, "the 1988 amendment to section 130(c) of the Code was intended to allow assignments without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments." Clearly, the fact that the claimant had a security interest in the funding assets did not prevent the assignment from being a qualified assignment. Nor did the fact that the assignee held the settlement proceeds in trust prior to the purchase of the funding assets prevent the assignment from being a qualified assignment.

In summary, the 1988 amendment to section 130(c) precludes any argument that an otherwise qualified assignment fails because the claimant receives the current economic benefit of settlement funds or funding assets that are held in trust.

Rev. Proc. 93-34 and Its Underlying Policy

Rev. Proc. 93-34 also supports the conclusion that the economic benefit doctrine does not apply to settlement proceeds that are held in trust in the context of a qualified assignment under section 130. Rev. Proc. 93-34 permits a QSF to make a "qualified assignment" under section 130 by treating the QSF as a "party to

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6 Private letter rulings referred to herein are not cited as precedent under section 6110(k)(3), but rather to illustrate the thinking of the IRS on the issues addressed.

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the suit or agreement" as required by section 130(c)(1). The premise underlying the revenue procedure is that the economic benefit doctrine does not apply where settlement proceeds are held in a QSF before the QSF makes a qualified assignment to the ultimate assignee.

Although the revenue procedure sets forth numerous requirements for a QSF to be treated as a "party to the suit or agreement,"[7] the revenue procedure gives no indication that a QSF will be treated as a "party to the suit or agreement" for purposes of 130 *only if* the QSF holds funds for the benefit of more than one claimant. Indeed, the revenue procedure contains several references to "claimant" or "plaintiff" in the singular. For example, Section 4.10(3) of Rev. Proc. 93-34 requires that the funding asset purchased by the assignee in connection with an assignment by a QSF must relate to the liability to a "single claimant to make periodic payments for damages." Similarly, Section 4.10(1) of Rev. Proc. 93-34 requires that the claimant agree in writing to the assignee's assumption of the liability of the QSF to make periodic payments to the claimant. Each of these requirements presumes that identifiable assets may be set aside for the benefit of a single claimant, and the revenue procedure nonetheless concludes that the assignments are "qualified assignments" under section 130. Such a conclusion is clearly inconsistent with a conclusion that the economic benefit doctrine somehow applies to preclude a qualified assignment in the case of a single-claimant QSF.

Moreover, if the economic benefit doctrine were to apply in the case of a single-claimant QSF that makes a qualified assignment, then the doctrine would

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7 These requirements, as set forth in § 4.01 of Rev. Proc. 93-34, are:
(1) the claimant agrees in writing to the assignee's assumption of the DSF or QSF's obligation to make periodic payments to the claimant;
(2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) that is either:
(a) a claim arising out of personal injury, death, or property damage in the case of a DSF, or
(b) a claim asserting liability under CERCLA, arising out of a tort, breach of contract, or violation of law, or designated by the Commissioner in a revenue ruling or revenue procedure, in the case of a QSF;
(3) each qualified funding asset purchased by the assignee in connection with the assignment by the DSF or QSF relates to a liability to a single claimant to make periodic payments for damages;
(4) the assignee is not related to the transferor (or transferors) to the DSF or QSF within the meaning of sections 267(b) or 707(b)(1); and
(5) the assignee is neither controlled by, nor controls, directly or indirectly, the DSF or QSF.

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necessarily apply in the case of *every* QSF that makes a qualified assignment, including multiple-claimant QSFs, as well. As a general matter, application of the economic benefit doctrine is not restricted to a fund or trust with only a single beneficiary; the doctrine can apply to a fund or trust in which there are multiple beneficiaries – each with a specified share. *See Pulsifer v. Comm'r*, 64 T.C. 245 (1975) (holding that each of three children had to include in income in the year they won the Irish Sweepstakes the child's one-third share of the winnings that were irrevocably placed into an account with the court solely for the benefit of the children until they reached age of majority). In every case in which a QSF is established to satisfy the claims of multiple claimants, the rules of professional conduct require that a lawyer obtain advance approval from each client of that client's share of the aggregate settlement that funds the QSF.[8] After advance approval is obtained, each claimant has an allocated share of the amount paid to the QSF.[9] If the economic benefit doctrine were applied to trigger immediate receipt by the claimants of those shares, before settlements and qualified assignments were made, then no QSF could ever make a qualified assignment, and thus, Rev. Proc. 93-34 would be rendered meaningless. Clearly, Treasury and the IRS did not intend such a result.

Given the impact of the uncertainty regarding the application of the economic benefit doctrine to negotiations of structured settlements, we request that Treasury and the IRS publish guidance clarifying that the economic benefit doctrine does not apply to prevent a single-claimant QSF from making a qualified assignment under section 130. The attached draft revenue procedure, which would modify and

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[8] This ethical requirement is set forth in Rule 1.8(g) of the American Bar Association Model Rules of Professional Conduct, adopted in all 50 states, which provides, in pertinent part, as follows:

> A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of . . . the clients . . . unless each client consents after consultation, including disclosure of the existence and nature of all the claims . . . and of the participation of each person in the settlement.

The penalty for failure to obtain advance approval is forfeiture by the attorney of his or her legal fees. *See Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999) (adopting fee forfeiture as a remedy and remanding for trial the issue of whether the rule was violated).

[9] Even if allocation of the settlement proceeds among multiple claimants were not to occur before the QSF is funded, such an allocation would have to occur before the QSF could make a final distribution to the claimants of the funds held by the QSF.

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supercede Rev. Proc. 93-34, contains the type of guidance that would provide the requested clarification.

The requested clarification does not require ultimate resolution of whether the economic benefit doctrine ever applies to a QSF.[10] Rather, what is sought is merely a clarification that a QSF may make a qualified assignment in a case involving a single claimant.

Conclusion

Application of the economic benefit doctrine to prevent a qualified assignment would be contrary to the statutory language of section 130, Congress' intent underlying the 1988 amendment to the statute, and Rev. Proc. 93-34 and its underlying policy. As the IRS itself has recognized, the 1988 amendment to section 130 was intended to allow assignments of periodic payment liabilities without regard to whether a claimant has the current economic benefit of the settlement proceeds or other assets that will be used to fund the periodic payments.

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10 It is open to doubt that the economic benefit doctrine should ever apply to trigger immediate receipt of settlement proceeds by the claimant or claimants of a QSF solely because the QSF has a single claimant or because an allocation of settlement proceeds among multiple claimants has been made. First, there is no indication in the definition of a QSF or otherwise in the regulations or legislative history under section 468B that qualification as a QSF depends upon the number of claimants or the absence of an allocation of an aggregate settlement among the claimants. Second, a QSF is a separate taxable entity that reports and pays tax on the income earned by the QSF (at the highest applicable rate and without use of the lower brackets). Application of the economic benefit doctrine to a QSF could result in both the QSF and the claimant(s) having to report and pay tax on that income. Clearly, such double taxation is not a result intended by Congress, Treasury, or the IRS.

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Revised Rev. Proc. 93-34

1. PURPOSE

This revenue procedure clarifies that, if the requirements for a "qualified assignment" as described in section 130 of the Internal Revenue Code are otherwise satisfied, no amount will be treated as currently received by a claimant solely because a "designated settlement fund" described in section 468B(d)(2) of the Internal Revenue Code or a "qualified settlement fund" described in section 1.468B-1 of the Income Tax Regulations is used to hold monies (i) while claimants are being identified and the amounts allocated to each are being determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

This revenue procedure modifies and supercedes Rev. Proc. 93-34, which provides rules under which a designated settlement fund or a qualified settlement fund will be considered "a party to the suit or agreement" for purposes of section 130. In general, section 130 provides that an assignee may exclude from gross income amounts it receives for assuming the liability of a party to a suit or agreement to make described periodic payments of damages to a claimant.

2. BACKGROUND

.01 Section 130(a) of the Code provides that any amount received for agreeing to a qualified assignment is not included in gross income to the extent that the amount does not exceed the aggregate cost of any qualified funding assets.

.02 Section 130(c) of the Code defines a "qualified assignment" to mean any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness (in a case involving physical injury or physical sickness) if:

(1) the assignee assumes the liability from a person who is a party to the suit or agreement;

(2) the periodic payments are fixed and determinable as to the amount and time of payment;

(3) the periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of the payments;

(4) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability; and

(5) the periodic payments are excludable from the gross income of the recipient under section 104(a)(2).

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.03 Section 130(c) of the Code provides that the determination of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of the assignment which grants the recipient rights as a creditor greater than those of a general creditor. Under the statute, "a liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor." H.R. CONF. REP. NO. 100-1104 at 171 (1988). The statute also makes clear that "no amount is currently includible in the recipient's income solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor." Id.

.04 Section 130(d) of the Code defines a "qualified funding asset" as any annuity contract issued by a company licensed to do business as an insurance company under the laws of any state, or any obligation of the United States if:

(1) the annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment;

(2) the periods of the payments under the annuity contract or obligation are reasonably related to the periodic payments under the qualified assignment, and the amount of any such payment under the contract or obligation does not exceed the periodic payment to which it relates;

(3) the annuity contract or obligation is designated by the assignee as being taken into account under section 130 with respect to the qualified assignment; and

(4) the annuity contract or obligation is purchased by the assignee not more than 60 days before the date of the qualified assignment and not later than 60 days after the date of such assignment.

.05 Section 468B(d)(2) of the Code defines a "designated settlement fund" as any fund:

(1) that is established pursuant to a court order and that extinguishes completely the transferor's tort liability with respect to claims arising out of personal injury, death, or property damage;

(2) with respect to which no amount may be transferred other than in the form of qualified payments;

(3) that is administered by persons a majority of whom are independent of the transferor;

(4) that is established for the principal purpose of resolving and satisfying present and future claims against the transferor (or any related person or formerly related person) arising out of personal injury, death, or property damage;

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(5) under the terms of which the transferor (or any related person) may not hold any beneficial interest in the income or corpus of the fund; and

(6) with respect to which an election is made by the transferor.

.06 Section 1.468B-1(a) of the regulations provides that a qualified settlement fund is a fund, account, or trust that satisfies the requirements of section 1.468B-1(c). Section 1.468B-1(c) provides that a fund, account, or trust is a qualified settlement fund if:

(1) it is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

(2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or a related series of events) that has occurred and that has given rise to at least one claim asserting liability:

(a) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. 9601 et seq.; or

(b) arising out of a tort, breach of contract, or violation of law; or

(c) designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

.07 Section 1.468B of the regulations provides that a designated settlement fund is taxed in the manner described in section 1.468B-2, pertaining to qualified settlement funds. In addition, the rules for transferors to a qualified settlement fund described in section 1.468B-3 apply to transferors to a designated settlement fund and the rules for claimants of a qualified settlement fund described in section 1.468B-4 apply to claimants of a designated settlement fund.

.08 Section 1.468B-1(d)(1) of the regulations defines a "transferor" as a person that transfers (or on behalf of whom an insurer or other person transfers) money or property to a qualified settlement fund to resolve or satisfy claims described in section 1.468B-1(c)(2) against that person.

.09 Section 1.468B-3(f)(2)(i) of the regulations provides that, if a qualified settlement fund makes a distribution on behalf of a transferor to a person that is not a claimant, the distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to have made a payment to the actual recipient.

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3. SCOPE

This revenue procedure provides specific guidance on the requirements that must be satisfied in order for a designated settlement fund or qualified settlement fund to be treated as "a party to the suit or agreement" under section 130(c)(1) of the Code. In addition to the requirements provided by this revenue procedure, an assignment by a designated or qualified settlement fund of a liability to make periodic payments must also satisfy all the other requirements of section 130 to be a qualified assignment. No inference should be drawn regarding the application of section 130 to any other type of taxpayer.

This revenue procedure also clarifies that, if the requirements for a "qualified assignment" under section 130 have otherwise been satisfied, no amount will be treated as currently received by a claimant solely because a designated settlement fund or qualified settlement fund is used to hold monies while claimants are being identified and the amounts allocated to each are being determined and/or during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

4. APPLICATION

01. A fund, account or trust that otherwise satisfies the requirements of section 468B(d)(2) in the case of a designated settlement fund or section 1.468B-1(a) of the Income Tax Regulations in the case of a qualified settlement fund does not fail to be a designated settlement fund or a qualified settlement fund solely because the fund, account or trust holds monies that ultimately may be paid for the benefit of a single claimant pursuant to section 130.

02. If each of the following requirements is satisfied, a designated settlement fund or qualified settlement fund will be treated as a "party to the suit or agreement" within the meaning of section 130(c)(1) of the Code, and any periodic payments made by the fund or the ultimate assignee pursuant to a qualified assignment will be treated as excludable from the gross income of the recipient under section 104(a)(2) for purposes of section 130(c)(5) of the Code:

(1) the claimant agrees in writing to the assignee's assumption of the designated or qualified settlement fund's obligation to make periodic payments to the claimant;

(2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) that is either:

(a) a claim described in section 2.04(1) in the case of a designated settlement fund, or

(b) a claim described in section 2.05(2) in the case of a qualified settlement fund;

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(3) each qualified funding asset purchased by the assignee in connection with the assignment by the designated or qualified settlement fund relates to a liability to a single claimant to make periodic payments for damages;

(4) the assignee is not related to the transferor (or transferors) to the designated or qualified settlement fund within the meaning of sections 267(b) or 707(b)(1);

(5) the assignee is neither controlled by, nor controls, directly or indirectly, the designated or qualified settlement fund. For purposes of this section 4.01(5), examples of control include an assignee that is a corporation the stock of which is owned by the fund or an assignee that is a trust the trustee of which is the administrator of the fund; and

(6) the designated settlement fund or qualified settlement fund satisfies the requirements of section 4.03.

.03 A designated settlement fund or qualified settlement fund satisfies the requirements of this section 4.03 if the designated settlement fund or the qualified settlement fund holds monies (i) while the specific claimants and amounts payable to each are being identified and determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments. While the determination as to what constitutes a temporary period will be made on a facts and circumstances basis, an assignment pursuant to section 130 will always be considered to be made within a temporary period with respect to a particular claimant if the assignment occurs within 270 days following the later of: (1) the date on which the settlement between the designated settlement fund or qualified settlement fund and the claimant(s) is executed and (2) the date on which the specific amount payable to each claimant is determined. There is no minimum amount of time that a designated settlement fund or a qualified settlement fund must hold monies.

.04 If an assignment by a designated or qualified settlement fund satisfies the requirements of section 4.02 of this revenue procedure and all the other applicable requirements of section 130 of the Code—

(1) the assignment will be treated as a qualified assignment within the meaning of section 130,

(2) the transferor to the designated or qualified settlement fund will not be treated as receiving a deemed distribution described in section 2.09 of this revenue procedure when the qualified assignment is made,

(3) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies (i) while the specific claimants and amounts payable to each are being identified and determined and/or (ii) during a temporary period while there is being arranged and implemented a

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settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments, and

(4) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies that may ultimately be paid for the benefit of a single claimant.

5. EFFECTIVE DATE

This revenue procedure is effective for qualified assignments made after [Date].

6. EFFECT ON OTHER GUIDANCE

This revenue procedure modifies and supercedes Rev. Proc. 93-34.

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~~Rev. Proc. 93-34, 1993-2 CB 470, 08/10/1993, IRC Sec(s). 468b~~ Revised Rev. Proc. 93-34

1. PURPOSE

This revenue procedure ~~provides rules under which a~~ clarifies that, if the requirements for a "qualified assignment" as described in section 130 of the Internal Revenue Code are otherwise satisfied, no amount will be treated as currently received by a claimant solely because a "designated settlement fund" described in section 468B(d)(2) of the Internal Revenue Code or a "qualified settlement fund" described in section 1.468B-1 of the Income Tax Regulations is used to hold monies (i) while claimants are being identified and the amounts allocated to each are being determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

This revenue procedure modifies and supercedes Rev. Proc. 93-34, which provides rules under which a designated settlement fund or a qualified settlement fund will be considered "a party to the suit or agreement" for purposes of section 130. In general, section 130 provides that an assignee may exclude from gross income amounts it receives for assuming the liability of a party to a suit or agreement to make described periodic payments of damages to a claimant.

2. BACKGROUND

.01 Section 130(a) of the Code provides that any amount received for agreeing to a qualified assignment is not included in gross income to the extent that the amount does not exceed the aggregate cost of any qualified funding assets.

.02 Section 130(c) of the Code defines a "qualified assignment" to mean any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness (in a case involving physical injury or physical sickness) if:

(1) the assignee assumes the liability from a person who is a party to the suit or agreement;

(2) the periodic payments are fixed and determinable as to the amount and time of payment;

(3) the periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of the payments;

(4) the assignee's obligation on account of the personal injuries or sickness is ~~not~~no greater than the obligation of the person who assigned the liability; and

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(5) the periodic payments are excludable from the gross income of the recipient under section 104(a)(2).

.03 Section 130(c) of the Code provides that the determination of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of the assignment which grants the recipient rights as a creditor greater than those of a general creditor. Under the statute, "a liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor." H.R. CONF. REP. NO. 100-1104 at 171 (1988). The statute also makes clear that "no amount is currently includible in the recipient's income solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor." Id.

.04 Section 130(d) of the Code defines a "qualified funding asset" as any annuity contract issued by a company licensed to do business as an insurance company under the laws of any state, or any obligation of the United States if:

(1) the annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment;

(2) the periods of the payments under the annuity contract or obligation are reasonably related to the periodic payments under the qualified assignment, and the amount of any such payment under the contract or obligation does not exceed the periodic payment to which it relates;

(3) the annuity contract or obligation is designated by the assignee as being taken into account under section 130 with respect to the qualified assignment; and

(4) the annuity contract or obligation is purchased by the assignee not more than 60 days before the date of the qualified assignment and not later than 60 days after the date of such assignment.

.~~04~~05 Section 468B(d)(2) of the Code defines a "designated settlement fund" as any fund:

(1) that is established pursuant to a court order and that extinguishes completely the transferor's tort liability with respect to claims arising out of personal injury, death, or property damage;

(2) with respect to which no amount may be transferred other than in the form of qualified payments;

(3) that is administered by persons a majority of whom are independent of the transferor;

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(4) that is established for the principal purpose of resolving and satisfying present and future claims against the transferor (or any related person or formerly related person) arising out of personal injury, death, or property damage;

(5) under the terms of which the transferor (or any related person) may not hold any beneficial interest in the income or corpus of the fund; and

(6) with respect to which an election is made by the transferor.

.~~05~~06 Section 1.468B-1(a) of the regulations provides that a qualified settlement fund is a fund, account, or trust that satisfies the requirements of section 1.468B-1(c). Section 1.468B-1(c) provides that a fund, account, or trust is a qualified settlement fund if:

(1) it is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

(2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or a related series of events) that has occurred and that has given rise to at least one claim asserting liability:

(a) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. 9601 et seq.; or

(b) arising out of a tort, breach of contract, or violation of law; or

(c) designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

.~~06~~07 Section 1.468B of the regulations provides that a designated settlement fund is taxed in the manner described in section 1.468B-2, pertaining to qualified settlement funds. In addition, the rules for transferors to a qualified settlement fund described in section 1.468B-3 apply to transferors to a designated settlement fund and the rules for claimants of a qualified settlement fund described in section 1.468B-4 apply to claimants of a designated settlement fund.

.~~07~~08 Section 1.468B-1(d)(1) of the regulations defines a "transferor" as a person that transfers (or on behalf of whom an insurer or other person transfers) money or property to a qualified settlement fund to resolve or satisfy claims described in section 1.468B-1(c)(2) against that person.

.~~08~~09 Section 1.468B-3(f)(2)(i) of the regulations provides that, if a qualified settlement fund makes a distribution on behalf of a transferor to a person that is not a claimant, the

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distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to have made a payment to the actual recipient.

3. SCOPE

This revenue procedure provides specific guidance on the requirements that must be satisfied in order for a designated settlement fund or qualified settlement fund to be treated as "a party to the suit or agreement" under section 130(c)(1) of the Code. In addition to the requirements provided by this revenue procedure, an assignment by a designated or qualified settlement fund of a liability to make periodic payments must also satisfy all the other requirements of section 130 to be a qualified assignment. No inference should be drawn regarding the application of section 130 to any other type of taxpayer.

This revenue procedure also clarifies that, if the requirements for a "qualified assignment" under section 130 have otherwise been satisfied, no amount will be treated as currently received by a claimant solely because a designated settlement fund or qualified settlement fund is used to hold monies while claimants are being identified and the amounts allocated to each are being determined and/or during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

4. APPLICATION

01. A fund, account or trust that otherwise satisfies the requirements of section 468B(d)(2) in the case of a designated settlement fund or section 1.468B-1(a) of the Income Tax Regulations in the case of a qualified settlement fund does not fail to be a designated settlement fund or a qualified settlement fund solely because the fund, account or trust holds monies that ultimately may be paid for the benefit of a single claimant pursuant to section 130.

~~.01 A~~02. If each of the following requirements is satisfied, a designated settlement fund or ~~a~~ qualified settlement fund will be treated as "a party to the suit or agreement" within the meaning of section 130(c)(1) of the Code ~~if each of the following requirements is satisfied~~, and any periodic payments made by the fund or the ultimate assignee pursuant to a qualified assignment will be treated as excludable from the gross income of the recipient under section 104(a)(2) for purposes of section 130(c)(5) of the Code:

(1) the claimant agrees in writing to the assignee's assumption of the designated or qualified settlement fund's obligation to make periodic payments to the claimant;

(2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) that is either:

(a) a claim described in section 2.04(1) in the case of a designated settlement fund, or

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(b) a claim described in section 2.05(2) in the case of a qualified settlement fund;

(3) each qualified funding asset purchased by the assignee in connection with the assignment by the designated or qualified settlement fund relates to a liability to a single claimant to make periodic payments for damages;

(4) the assignee is not related to the transferor (or transferors) to the designated or qualified settlement fund within the meaning of sections 267(b) or 707(b)(1); ~~and~~

(5) the assignee is neither controlled by, nor controls, directly or indirectly, the designated or qualified settlement fund. For purposes of this section 4.01(5), examples of control include an assignee that is a corporation the stock of which is owned by the fund or an assignee that is a trust the trustee of which is the administrator of the fund~~.~~; and

(6) the designated settlement fund or qualified settlement fund satisfies the requirements of section 4.03.

.03 A designated settlement fund or qualified settlement fund satisfies the requirements of this section 4.03 if the designated settlement fund or the qualified settlement fund holds monies (i) while the specific claimants and amounts payable to each are being identified and determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments. While the determination as to what constitutes a temporary period will be made on a facts and circumstances basis, an assignment pursuant to section 130 will always be considered to be made within a temporary period with respect to a particular claimant if the assignment occurs within 270 days following the later of: (1) the date on which the settlement between the designated settlement fund or qualified settlement fund and the claimant(s) is executed and (2) the date on which the specific amount payable to each claimant is determined. There is no minimum amount of time that a designated settlement fund or a qualified settlement fund must hold monies.

.~~02~~04 If an assignment by a designated or qualified settlement fund satisfies the requirements of section ~~4.01~~4.02 of this revenue procedure and all the other applicable requirements of section 130 of the Code~~;~~—

(1) the assignment ~~is~~will be treated as a qualified assignment within the meaning of section ~~130 and~~130,

(2) the transferor to the designated or qualified settlement fund will not be treated as receiving a deemed distribution described in section ~~2.08~~2.09 of this revenue procedure when the qualified assignment is made~~.~~;

(3) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies (i) while the specific claimants and amounts payable to each are being identified and determined

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and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments, and

(4) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies that may ultimately be paid for the benefit of a single claimant.

5. EFFECTIVE DATE

This revenue procedure is effective for qualified assignments made after ~~August 10, 1993.~~ [Date].

~~DRAFTING INFORMATION~~

~~The principal author of this~~

6. EFFECT ON OTHER GUIDANCE

This revenue procedure ~~is Linda M. Kroening of the Office of the Assistant Chief Counsel (Income Tax & Accounting)~~modifies and supercedes Rev. ~~For further information regarding this revenue procedure, contact Linda M~~Proc. ~~Kroening at (202) 6229~~3~~-4910 (not a toll-free call).~~ 34.

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STRUCTURED SETTLEMENTS AND SINGLE-CLAIMANT QUALIFIED SETTLEMENT FUNDS: REGULATING IN ACCORDANCE WITH STRUCTURED SETTLEMENT HISTORY

Jeremy Babener *

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* Jeremy Babener is a 2010 J.D. Candidate at New York University School of Law. The author would like to thank Patrick J. Hindert and Richard B. Risk, Jr. for valuable comments on a previous draft. In addition, those in the structured settlement industry made much of the current and practical information in this Article possible, including those at the National Structured Settlements Trade Association, the National Association of Settlement Purchasers, and the Society of Settlement Planners. Lastly, thanks also to Gail K. Johnson of the Department of Justice's Federal Tort Claims Act Section for her limitless mentorship, and New York University School of Law Professor Lily Batchelder for her guidance and support.

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INTRODUCTION

In 1982, Congress created a subsidy for a relatively new type of settlement: the structured settlement. Rather than paying plaintiff[1] with a single check of $1 million, defendant pays plaintiff $2 million in increments over the next twenty years. As Congress would later

1. Because some personal injury settlements are made before a law suit is filed, the terms "plaintiffs" and "claimants" will be used interchangeably in this Article. Because the cost of settling is typically borne by a defendant's liability insurance carrier, Barbara D. Goldberg & Kenneth Mauro, Utilizing Structured Settlements, in EVALUATING & SETTLING A PERSONAL INJURY CASE: PLAINTIFFS' AND DEFENDANTS' PERSPECTIVES 31, 35–36 (Practising Law Institute, 2001), the term "defendants" and "liability insurers" will be used interchangeably, unless distinguishing is necessary for a particular topic.

explain, spreading the receipt over a long period of time serves the public interest by preventing a plaintiff from prematurely dissipating that money,[2] and possibly becoming dependent upon the state. Thus, it extended the income tax exclusion of personal injury settlement monies to periodic payments, creating the structured settlement tax subsidy.

In so doing, Congress emphasized the application of two well-established tax doctrines that would withhold tax subsidy eligibility if violated: constructive receipt and economic benefit. Congress made clear that a personal injury plaintiff who obtained such control over their settlement funds would not receive the subsidy's benefit. Thus, Congress established a monetary incentive to sacrifice control and immediate receipt of one's settlement monies.

While the legislation immediately began increasing the use of structured settlements, it became clear, at least early on, that defendants were capturing much of the benefit by the conclusion of settlement negotiations. Though this usurpation may have lessened over time as plaintiff advisors became more knowledgeable about structured settlements, it continues today. During the last decade, plaintiffs have used a new entity to capture more of that benefit: the qualified settlement fund.[3] Plaintiffs agree with defendants on a lump-sum settlement amount, and direct that amount to a qualified settlement fund. Thereafter, plaintiffs can structure a settlement to maximize its benefits, without the conflicting objectives inherent in plaintiff-defendant negotiations. Such a fund can be used over the objection or even without the knowledge of defendants.

Because the use of this fund by single-claimants may break two important tax rules that Congress originally applied to the structured settlement tax subsidy—the constructive receipt[4] and economic bene-

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2. Anecdotal evidence suggests that the vast majority of lump-sum settlement recipients prematurely dissipate their settlement moneys. However, though many have cited to the statistic that 90% of such recipients prematurely dissipate their monies within five years, the statistic has been found to be unsubstantiated. Jeremy N. Babener, Note, Justifying the Structured Settlement Tax Subsidy: The Use of Lump Sum Settlement Monies, 6 N.Y.U. J. L. & Bus. 127 (2009); see Laura J. Koenig, Lies, Damned Lies, and Statistics? Structured Settlements, Factoring, and the Federal Government, 82 Ind. L. J. 809, 810 (2007); Adam F. Scales, Against Settlement Factoring? The Market in Tort Claims Has Arrived, 2002 Wis. L. Rev. 859, 870, 873 (2002).

3. See Part V.B.

4. A taxpayer acquires constructive receipt of monies, though not actually in the taxpayer's possession, once the monies have been set aside for his or her exclusive use and can be drawn upon at any time. Treas. Reg. § 1.451-2(a) (as amended in 1979); see infra note 80.

fit doctrines[5]—it is unclear if such claimants can make use of qualified settlement funds and still access the subsidy. Thus, qualified settlement funds have not been widely used because plaintiffs and their advisors do not want to risk the loss of the structured settlement tax subsidy.

Treasury regulations[6] could cure the ambiguity, but should do so in accordance with structured settlement history, and in the interest of public policy. Letters to the Treasury have been written for and against the approval of single-claimant qualified settlement funds being eligible for the 1982 tax subsidy when establishing structured settlements. At least one law review article has also been written in favor of single-claimant qualified settlement funds.[7] Building on prior work, this Article will demonstrate how Treasury regulations extending structured settlement tax subsidy eligibility to structured settlements produced by single-claimant qualified settlement funds would, if found to violate tax doctrine, only constitute a further step in

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5. A taxpayer acquires the economic benefit of monies when they are unconditionally and irrevocably transferred to him or her, though not necessarily accessible. For example, an employee acquires the economic benefit of an irrevocable contribution to a deferred compensation plan where the plan is vested in the employee and secured against the employer's creditors. See Minor v. United States, 772 F.2d 1472, 1474 (9th Cir. 1985) (citing Rev. Rul. 60-31, 1960-1 C.B. 174, 179); infra note 81 (discussing the well-known Sproull v. Comm'r decision). The doctrine has been called "a limited, technical device, created and advanced by the government in order to collect taxes from cash basis taxpayers as soon as possible." Thomas v. United States, 45 F. Supp. 2d 618, 625 (S.D. Ohio 1999). That court established three elements that, together, trigger economic benefit:

> (1) There must be some fund in which money or property has been placed;
>
> (2) The fund must be irrevocable and beyond the reach of the creditors of the party who transferred the funds to the escrow or trust; and
>
> (3) The beneficiary must have vested rights to the money, with receipt conditioned only on the passage of time.

Id. at 620 (1999) (citing Sproull v. Comm'r, 16 T.C. 244 (1951), aff'd, 194 F.2d 541 (6th Cir. 1952)). The Court stated that a beneficiary's interest in a fund is "'vested' if it is nonforfeitable." Id. at 621 (citing I.R.S. Gen. Couns. Mem. 33,733 (Nov. 21, 1966)).

6. The Secretary of the Treasury, empowered to "prescribe all needful rules and regulations for the enforcement of [the Tax Code]," I.R.C. § 7805(a) (2006), has "delegated much of this rulemaking authority to the I.R.S. Chief Counsel's Office." LEANDRA LEDERMAN & STEPHEN W. MAZZA, TAX CONTROVERSIES: PRACTICE AND PROCEDURE 31 (3d ed. 2009). Thus, while the Treasury Department remains the official source of such regulations, id., this Article alternatively calls for new regulations from the Treasury and the Internal Revenue Service (IRS). Of course, Congress could also act to achieve the same result.

7. Richard B. Risk, Jr., A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant, 23 VA. TAX REV. 639 (2004) [hereinafter Risk, A Case].

an ongoing deconstruction of the constructive receipt and economic benefit doctrines, performed through legislative, administrative, and regulatory action. Moreover, the degradation of these doctrines, at least in the context of single-claimant qualified settlement funds, would serve to fulfill the purpose of the original 1982 legislation, despite the apparent inconsistency. Thus, this Article recommends the issuance of Treasury regulations extending structured settlement tax subsidy eligibility to structured settlements produced by single-claimant qualified settlement funds.

Part I introduces the reader to the use and popularity of structured settlements, explaining how the tax subsidy increases the value of a structured settlement. Part II details the early history of structured settlements, including the 1979 Internal Revenue Service (IRS) rulings and 1982 legislation establishing the tax subsidy. It highlights both the application of the economic benefit and constructive receipt doctrines, as well as the purpose of the 1982 legislation: preventing premature lump-sum dissipation. Part III narrates the subsequent erosion of the constructive receipt and economic benefit doctrines. It details the birth and later implicit approval of "factoring," the selling of structured settlements by former claimants. This section suggests that the erosion of the two doctrines may in fact serve the purpose of the original 1982 legislation. Part IV demonstrates the need for the use of single-claimant funds by elaborating on the methods defendants and their liability insurers have used to minimize settlement costs. This section argues that it is in the interest of public policy to direct the benefits of structuring a settlement away from defendants, and toward plaintiffs, so long as structured settlements are not discouraged. Part V describes how single-claimant qualified settlement funds can be used to capture increased benefits for plaintiff, and argues that the continued erosion of the economic benefit doctrine in relation to structured settlements is consistent with past erosion, and serves the purpose of the original 1982 legislation creating the tax subsidy.

I.
WHAT IS A STRUCTURED SETTLEMENT?

A. A Popular Tool

As early as 1981, structured settlements[8] were being hailed as "the wave of the future."[9] Predictions were made that "social and professional pressure"[10] would require the consideration of structured settlements in negotiations.[11] These predictions were proven out.[12]

By all accounts, structured settlements are being used with great frequency. In a large study of over 1,750 commercial liability bodily injury claims, 12% resulted in structured settlements.[13] Approximately one-third of injured victims offered a structured settlement agree to it.[14] Together, these two pieces of information suggest that

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8. The Tax Code defines a structured settlement as an arrangement established by
> (i) suit or agreement for the periodic payment of damages excludable from the gross income of the recipient under section 104(a)(2), or (ii) [an] agreement for the periodic payment of compensation under any workers' compensation law excludable from the gross income of the recipient under section 104(a)(1) . . . [where periodic payments are] (i) of the character described in subparagraphs (A) and (B) of section 130(c)(2), and (ii) payable by a person who is a party to the suit or agreement or to the workers' compensation claim or by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with section 130.

I.R.C. § 5891 (2006) (defining the term for purposes of section 5891). Section 130(c)(2) provides, "(A) such periodic payments are fixed and determinable as to amount and time of payment, (B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments." I.R.C. § 130(c)(2)(A)–(B) (2006).

9. Howard Rudnitsky & Jeff Blyskal, Something for Everyone, FORBES, 29, 29 (Jan. 19, 1981) (quoting attorney Fred Levin upon agreeing to a structured settlement worth over $10 million).

10. Structuring Settlements: A Roundtable, 19 TRIAL 70, 80 (Jan. 1983) [hereinafter A Roundtable] (comments of Lawrence Charfoos).

11. Id. By 1983, commentators were projecting that plaintiff attorneys might soon face malpractice suits for not informing their clients of the option. Id. at 79 (comments of Herb Cumming); see also Amy J. Conner, Is Plaintiffs' Lawyer Liable for Not Offering Structured Settlement?, LAW. WKLY. USA, Aug. 6, 2001, at 1, available at http://www.jmwsettlements.com/structured_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf.

12. Christopher R. Gullen, What Attorneys Need to Learn From Grillo v. Pettiete, MICH. B. J., Aug. 2003, at 28 (discussing a legal malpractice settlement for more than $4 million resulting from a former personal injury plaintiff suing the attorney and guardian ad litem, both of whom recommended the acceptance of a cash settlement).

13. INSURANCE SERVICES OFFICE, INC., CLOSED CLAIM SURVEY FOR COMMERCIAL GENERAL LIABILITY: SURVEY RESULTS, 1997, 22 (1997) [hereinafter ISO SURVEY] (finding that nearly 25% of the claims where claimants received over $300,000 involved structured settlements).

14. Tax Treatment of Structured Settlements: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 106th Cong. 38 (1999) (statement of

more than a third of personal injury claimants are offered a structured settlement. So much use amounts to over $6 billion of structured settlement premiums being purchased each year,[15] an estimated 5% of the $130 billion of total annual personal injury settlements.[16] Even the 2008 financial crisis does not appear to have significantly harmed the structured settlement industry.[17] Because structured settlements have been available for over three decades, there are currently two million Americans holding some $100 billion in structured settlements.[18]

Thomas W. Little, Former President of National Structured Settlements Trade Association, on behalf of the NSSTA); Letter from Malcolm Deener, President, NSSTA, to Gregory F. Jenner, Acting Assistant Secretary for Tax Policy, Department of the Treasury, and Donald L. Korb, Chief Counsel, I.R.S. (May 10, 2004), available at http://www.risklawfirm.com/files/DeweyBallentineItrtoSenBaucus06-29-04.pdf [hereinafter NSSTA Letter].

15. Risk, A Case, supra note 7, at 644 n.13 (citing Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003)); cf. Scales, supra note 2, at 882 n.72 (citing Press Release, National Structured Settlements Trade Ass'n, Structured Settlements Industry Reports 19 Percent Surge in Demand During 2001; $6.05B Is Best Year in History (Feb. 5, 2002)). In the past, some have estimated the value to reach some $10 billion, Tax Treatment of Structured Settlements: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 106th Cong. 78 (1999) [hereinafter 1999 Hearing] (written statement of J.G. Wentworth, a finance company that purchases and securitizes structured settlements), or even $12 billion. Anthony Riccardi & Thomas Ireland, A Primer on Annuity Contracts, Structured Settlements, and Periodic-Payment Judgments, 12 J. LEGAL ECON. 1, 8 (2002–2003) (citing http://www.nssta.com).

16. See Christopher Sheffield, Evolve Financial Division Ramps Up Marketing to Grow Settlement Business, MEMPHIS BUS. J., Feb. 1, 2008, available at http://birmingham.bizjournals.com/memphis/stories/2008/02/04/story11.html. The study by Towers Perrin reported total tort costs in the United States of $252 billion in 2007. TOWERS PERRIN, 2008 UPDATE OF U.S. TORT COST TRENDS 3, available at http://www.towersperrin.com/tp/getwebcachedoc?webc=USA/2008/200811/2008_tort_costs_trends.pdf. The total incorporates the benefits paid or expected to be paid to third parties, defense costs, and administrative expenses. Id. at 8. Patrick J. Hindert, author of STRUCTURED SETTLEMENTS AND PERIODIC PAYMENTS, suggests that payments to injury victims and their attorneys reached $161 billion in 2006, based on one of the Towers Perrin study principals. Patrick J. Hindert, Structured Settlement Surveys, BEYOND STRUCTURED SETTLEMENTS, Nov. 23, 2008, http://s2kmblog.typepad.com/rethinking_structured_set/2008/11/structured-settlement-surveys.html.

17. Some in the industry believe that the current economic uncertainty and declining investment performance drives more people to consider structured settlements. Telephone Interview with Betty Gregware, Sales Executive, John Hancock Life Insurance Co. (Feb. 29, 2009) [hereinafter Gregware Interview]; E-mail from John McCulloch, Vice President National Marketing Director, EPS Settlement Group, Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 9, 2009, 8:30:59 EST) (on file with author) [hereinafter McCulloch E-mail] (predicting increased use of structured settlements as a result of a "flight to quality").

18. See Press Release, J.G. Wentworth, The #1 Reason Consumers Sell Their Structured Settlements Is to Pay Bills, According to Survey by J.G. Wentworth (Nov.

Unsurprisingly, an industry has spawned and expanded to meet and drive demand. As of 2000, there were approximately 430 full-time structured settlement brokers.[19] As of 2001, more than two dozen insurance companies were selling structured settlement annuities.[20]

Early on, structured settlements faced opposition within the plaintiff attorney field.[21] By 1983, however, some plaintiff attorneys were already initiating structured settlement discussions of their own accord.[22] Currently, they are applauded by plaintiffs, defendants, and brokers alike.[23] The National Structured Settlements Trade Associations (NSSTA) can point to many supporters of structured settlements.[24] For example, Andrew J. Imparato, the President of the American Association of People with Disabilities, said, "[s]tructured settlements are a model benefit for people with disabilities."[25]

Because the tax exemption favors the plaintiff, defendant, and broker,[26] the exemption rarely faces serious scrutiny. Perhaps the most thorough examination, aside from a rare few academic articles, was provided by a sister industry spawned in the 1990s.[27] The "factoring"[28] industry, populated by companies who purchase the future stream of income of a structured settlement annuity from former claimants, was strongly criticized by the structured settlement selling

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4, 2008), available at http://www.jgwentworth.com/About/News/Press/Detail.aspx?i=46 [hereinafter The #1 Reason].

19. Richard B. Risk, Jr., Structured Settlements: The Ongoing Evolution From a Liability Insurer's Ploy to an Injury Victim's Boon, 36 TULSA L.J. 865, 879 (2001) [hereinafter Risk, Structured Settlements].

20. Id. at 878.

21. Vasilios B. Choulos, Structured Settlements: Cure or Curse?, 16 TRIAL 73, 74 (Nov. 1980).

22. A Roundtable, supra note 10, at 72 (comments of Herb Cumming).

23. See Scales, supra note 2, at 887.

24. National Structured Settlements Trade Association, Independent Voices, http://www.nssta.com/i4a/pages/index.cfm?pageid=3291 (last visited Jan. 20, 2009).

25. Id. (quoting Andrew J. Imparato, President, American Association of People with Disabilities).

26. Scales, supra note 2, at 887.

27. Margaret Mannix, Settling for Less: Should Accident Victims Sell Their Monthly Payouts?, U.S. NEWS & WORLD REP., Jan. 25, 1999, at 62; Vanessa O'Connell, Like It Or Lump It: Thriving Industry Buys Insurance From Injured Plaintiffs, WALL ST. J., Feb. 25, 1998, at A1.

28. The term "factoring" was once used as a derogatory term by insurance companies; however, since incorporation into federal law, I.R.C. § 5891 (2006), the term has been increasingly used by purchasing company insiders. Telephone Interview with Matt Bracy, General Counsel, Settlement Capital Corp. (Mar. 12, 2009) [hereinafter Bracy Interview].

industry in the mid and late 1990s.[29] Much of the negative criticism of the structured settlement industry was made during this time.[30]

B. The Typical Structured Settlement

The typical structured settlement is agreed to after a lawsuit has been filed,[31] but before substantial involvement by a judge.[32] Structured settlements vary in value. One large survey found that two-thirds of claims using structured settlements involved "major injuries," averaging a total payout of $408,000.[33] The other one-third percent averaged a total payout of $210,000.[34] However, testimony on behalf of the factoring industry represented that more than half of structured settlement premiums fall below $50,000, and that less than 13% exceed $250,000.[35] In any case, some practitioners suggest that a structured settlement can be created for $10,000 or $20,000,[36] though values as low as $5,000 and $2,700 have been reported.[37] The average stream of periodic payments guaranteed by a structured settlement is for twenty years.[38] However, structured settlements commonly include life-contingent payments as a component.[39]

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29. Risk, Structured Settlements, supra note 19, at 883.

30. See infra Part III.

31. Telephone Interview with Jack L. Meligan, Plaintiff Loyal Settlement Planner, Settlement Professionals Inc. (Feb. 5, 2009) [hereinafter Meligan Interview].

32. E-mail from William L. Neff, Partner, Hogan & Hartson LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 23, 2009, 19:29:04 EST) (on file with author) [hereinafter Neff E-mail, Feb. 23, 2009].

33. ISO SURVEY, supra note 13, at 22.

34. Id.

35. 1999 Hearing, supra note 15, at 17 (statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

36. Leo Andrada, Structured Settlements: The Assignability Problem, 9 S. CAL. INTERDIS. L.J. 465, 468, 472 (2000). Life insurance companies set minimum annuity values. McCulloch E-mail, supra note 17. For example, John Hancock Life has a policy minimum of $10,000. Gregware Interview, supra note 17.

37. Meligan Interview, supra note 31. Meligan cites the $2,700 structured settlement as a one-time occurrence, and $5,000 structured settlements as rare, occurring at his office perhaps once per year. Id. Structured settlements for $20,000 are seen more regularly. Id.

38. 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

39. E-mail from Craig H. Ulman, Counsel to NSSTA to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 16, 2009, 16:06:14 EST) (on file with author) [hereinafter Ulman E-mail, Feb. 16, 2009]. Life contingent payments are periodic payments made to a beneficiary until their death. See generally BLACK'S LAW DICTIONARY (West 8th ed. 2004) (defining "annuity").

Not all of a defendant's payment[40] is typically used to purchase an annuity.[41] On average, half of the payout is transferred as an up-front lump-sum to plaintiff, while the other half is paid through the purchase of an annuity[42] via a structured settlement company.[43] From the latter purchase, a structured settlement broker will typically receive a commission of between 2%[44] and 4%.[45]

Anti-assignment clauses, stipulations in the contract preventing plaintiff from transferring rights to the future stream of income, have often been included in settlement agreements.[46] However, these are not necessarily followed,[47] and some courts choose not to enforce them.[48] The practice of "factoring," selling one's right to receive fu-

40. The cost of the structured settlement is typically borne by a defendant's liability insurance carrier. Goldberg & Mauro, supra note 1, at 35–36.

41. See Thomas C. Downs, Superfund Colloquium: Periodic Payment of Claims: New Hope for CERCLA Settlements?, 8 TUL. ENVTL. L.J. 387 (1995).

42. ISO SURVEY, supra note 13, at 22; Gregware Interview, supra note 17 (making a back-of-the-envelope estimation that, of those settlements with structured components, perhaps 40% to 50% of the total settlement is structured). Structured settlement companies are often subsidiaries of insurance companies. See Dan Luther, Trusts May be Superior to 'Structured Settlements', 129 TRUSTS & ESTATES, 28, 28 (Dec. 1990).

43. As will be seen in the next section, infra Part I.C., the structured settlement company assumes the defendant's liability through novation, and purchases an annuity to make periodic payments to the claimant from a life insurance company. Thus, the structured settlement company can also be referred to as an assignee, having been assigned liability from the defendant. This Article will refer to such a company as a "structured settlement company."

44. Risk, Structured Settlements, supra note 19, at 890.

45. Robert W. Wood, Single-Claimant Qualified (468B) Settlement Funds?, TAX NOTES, Jan. 5, 2009, at 71, 73 [hereinafter Wood, TAX NOTES] (noting that the commission will be paid for by the life insurance company); 1999 Hearing, supra note 15, at 19 (1999) (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers). The standard commission is 4%. E-mail from Patrick J. Hindert, Managing Director, S2KM Ltd. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Sept. 4, 2009, 12:00:15 EDT) (on file with author) [hereinafter Hindert E-mail, Sept. 4, 2009]. However, multiple agents frequently share the 4%, thus reducing any individual agent's take. Id. One commentator notes that such commission sharing can create a conflict of interest, sometimes not disclosed to the structured settlement recipient. Id.

46. Scales, supra note 2, at 902.

47. See Settlement Funding, LLC v. Jamestown Life Ins. Co., 78 F. Supp. 2d 1349, 1364 (N.D. Ga. 1999) (noting that the court was "not convinced that there exists a public policy against the assignability of structured payments to protect the recipients of the payments 'from squandering their benefits'"). But see C.U. Annuity Service Corp. v. Scott Young, 722 N.Y.S.2d 236 (N.Y. App. Div. 2001); Green v. Safeco Life Ins., 727 N.E.2d 393 (Ill. App. Ct. 2000); Liberty Life Assur. Co. of Boston v. Stone Street Capital, Inc., 93 F. Supp. 2d 630 (D. Md. 2000); Singer Asset Finance Co. v. Bachus, 741 N.Y.S.2d 618 (N.Y. App. Div. 2002).

48. Settlement Funding, LLC, 78 F. Supp. 2d at 1364.

ture structured settlement payments, is a common transaction that will be discussed later in Part III. Factoring transactions, and legislative decisions regarding them, have done much to erode the tax doctrines discussed in this Article, as applied to structured settlements.

C. A Tax Subsidy at Work

Structured settlements for personal injury claims are made between parties as an alternative to a lump-sum payment.[49] Rather than a defendant writing plaintiff a check for $1 million, for example, the defendant could agree to pay plaintiff $2 million in installments on a semi-annual or monthly basis over a period of years. Because the defendant possesses the bulk of the amount for those years, and can invest it, more money can be paid out later on. Business defendants incapable of making an immediate high-value payment are also able to keep their doors open by delaying payment. Thus, the configuration of a structured settlement is inherently attractive to certain parties, in certain situations.[50]

However, the tax treatment of the structured settlement renders the arrangement even more attractive, and to both sides.[51] It is said that the $6 billion market for structured settlement annuities "owes its existence almost entirely"[52] to what the Joint Committee on Taxation calls a "tax subsidy." [53] The tax subsidy does this by extending the Tax Code's favored treatment of lump-sum awards and settlements for physical injuries to periodic payments. It has long been true that

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49. Other alternatives, like trusts, exist. See generally Luther, supra note 42.

50. NSSTA can produce countless supporters of the tax subsidy, National Structured Settlements Trade Association, Independent Voices, http://www.nssta.com/i4a/pages/index.cfm?pageid=3291 (last visited Feb. 2, 2009), and many articles have been written listing the advantages. E.g., Dirk Yandell, Advantages and Disadvantages of Structured Settlements, 5 J. LEGAL ECON. 71 (1995).

51. Goldberg & Mauro, supra note 1, at 68; A Roundtable, supra note 10, at 70 (comments of Lawrence Charfoos).

52. Scales, supra note 2, at 895 (citing A Roundtable, supra note 10, at 72 (comments of Charles Krause); 1999 Hearing, supra note 15, at 32–33 (Statement of Timothy J. Trankina, Peachtree Settlement Funding)).

53. JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999); see Meligan Interview, supra note 31 (stating that many fewer structured settlements would occur without the tax exemption); Telephone Interview with Randy Dyer, Former Executive Vice President, NSSTA (Feb. 18, 2009) [hereinafter Dyer Interview] (stating that without the tax exemption, structured settlements would be much less common). But see McCulloch E-mail, supra note 17 (arguing that the long term security and flexibility of structured settlements are stronger reasons for a plaintiff to structure than the tax benefit); Ulman E-mail, Feb. 16, 2009, supra note 39 (noting that additional benefits such as protection against creditor claims and mortality risk might sometimes be more important to claimants).

plaintiffs do not include physical injury awards or settlement monies in gross income for purposes of taxation.[54] Once the plaintiff receives those monies and invests them, however, the gain derived is not exempted from taxation.[55]

However, IRS revenue rulings in the late 1970s, and Congress's enactment of the Periodic Payment Settlement Tax Act of 1982, approved a tax exemption that would allow personal injury money to be invested without incurring taxable earnings. In the 1982 Act, Congress amended section 104(a)(2) of the Tax Code to exclude personal physical injury and sickness damages "whether as lump-sums or as periodic payments."[56] Thus, plaintiffs could receive damages in installment payments, without losing the beneficial tax-exempt status of award or settlement monies.[57]

At the same time, Congress also established section 130, which operated on the defense side corresponding to section 104(a)(2)'s amendment affecting the plaintiff side. Section 130 exempts income

54. T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918).

55. See Rev. Rul. 79-313, 1979-2 C.B. 75 (citing Rev. Rul. 65-29, 1965-1 C.B. 59); Andrada, supra note 36, at 470 (citing Kovacs v. Comm'r, 100 T.C. 124 (1993), aff'd per curiam, 25 F.3d 1048 (6th Cir. 1994), cert. denied, 513 U.S. 963 (1994)); Goldberg & Mauro, supra note 1, at 38; Lawrence A. Frolik, The Convergence of I.R.C. § 104(a)(2), Norfolk & Western Railway Co. v. Liepelt and Structured Settlements: Tax Policy 'Derailed', 51 FORDHAM L. REV. 565, 566 (1983). But see I.R.C. § 103 (2006) (exempting interest on state and local bonds from gross income). Earnings on the award or settlement are taxed regardless of whether the parties calculated the lump-sum value based upon future investment. Frolik, supra, at 575.

56. I.R.C. § 104(a)(2) (2006) (emphasis added) (excluding "the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness"). Treasury regulations define "damages received whether by suit or agreement" to include amounts received, except for workmen's compensation, "through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution." Treas. Reg. § 1.104-1(c) (as amended in 1970). Considerable literature is dedicated to differentiating those types of injury payments that do and do not constitute physical injuries or physical sickness. E.g., Henry E. Smith, Symposium, Liability for Inchoate and Future Loss, 88 Va. L. Rev. 1953 (2002).

57. The exemption for these payments continues even upon plaintiff's death. Goldberg & Mauro, supra note 1, at 38 (citing Rev. Rul. 79-220, 1979-2 C.B. 74). States also hold lump sums and periodic payments to be tax exempt. National Structured Settlements Association, Structured Settlements: Financial Protection During Economic Crisis, Jan. 23, 2009, http://www.nssta.com/files/public/FINANCIAL_SECURITY_HAND-OUT_10-08.pdf. The exclusion affects state income taxes as well as federal. Many states use the federal definition of taxable income for their taxable base. E.g., CAL. REV. & TAX CODE § 17071 (West 2009). At least one state explicitly excludes compensation for personal injuries and sickness. Some states continue to exclude non-physical injuries and sickness. N.J. STAT. ANN. § 54A:6-6 (West 2009).

paid by defendants to structured settlement companies for taking on defendants' liability to make future payments to plaintiff through a "qualified assignment."[58] The income is exempt from tax "to the extent that such amount does not exceed the aggregate cost of any qualified funding assets,"[59] those assets being the annuity purchased to fund plaintiff's future payments.

Thus, a transfer of liability would follow these steps. First a defendant might pay $100,000 to a structured settlement company in consideration for the company assuming liability for plaintiff's future payments. The company pockets $3,000 as a fee, and purchases a $97,000 annuity. Because of section 130, the structured settlement company need only pay income tax on the $3,000 fee.[60]

The benefit to the defendant can be seen in the subsequent step. Defendant businesses can deduct personal injury damages paid as a business expense.[61] Thus, the lump-sum payment defendant makes to a structured settlement company will be immediately deductible.[62] That sum acts as an investment principal, which produces earnings over the future payout period. Neither the defendant, nor the structured settlement company, nor the plaintiff, will ever pay taxes on those earnings.[63] In this way, section 104(a)(2) and section 130 combine to create an incredibly beneficial settlement arrangement option

58. See I.R.C. § 130(a) (2006). A qualified assignment is defined as "any assignment of a liability to make periodic payments as damages . . . [where] such periodic payments are fixed and determinable as to amount and time of payment . . . [and] cannot be accelerated, deferred, increased, or decreased by the recipient of such payments." I.R.C. § 130(c) (2006).

59. See I.R.C. § 130(a) (2006). A qualified funding asset has many requirements, including three particularly substantive ones. First, the investment must be an "annuity contract issued by a . . . licensed . . . insurance company . . . or any obligation of the United States." I.R.C. § 130(d) (2006). Second, the timing and amounts of periodic payments must be "reasonably related," to the timing and amounts of payments owed to the plaintiff. Id.; Andrada, supra note 36, at 483 (citing I.R.C. § 130(d)). And third, the annuity must be purchased within sixty days of the qualified assignment. I.R.C. § 130(d)(4) (2006).

60. See Andrada, supra note 36. See generally I.R.C. § 130 (2006).

61. See Joseph W. Blackburn, Taxation of Personal Injury Damages: Recommendations for Reform, 56 TENN. L. REV. 661, 687 (1989) (citing I.R.C. § 165(a) (1986)); I.R.C. § 162 (2006 & Supp. II 2008).

62. See Andrada, supra note 36, at 482, n.59, 483. The defendant can only deduct the present value of the future stream of income, and not the entire expected output. In Ford Motor Co. v. Comm'r, Ford argued that a deduction of the full nominal value of expected output from twenty structured settlements was proper. Ford Motor Co. v. Comm'r, 102 T.C. 87, 90 (1994). This would have amounted to a nearly $24.5 million deduction. Id. However, the Tax Court ruled in favor of the commissioner, allowing only the deduction of cost of the annuities purchased. See id. at 104–05. The Sixth Circuit affirmed. Ford Motor Co. v. Comm'r, 71 F.3d 209 (6th Cir. 1995).

63. See Andrada, supra note 36, at 482.

from an income tax perspective. Together, they allow a smaller, immediately deductible payment from defendant, to create a larger payout for plaintiff.[64]

Defendant could of course pay the periodic payments to the plaintiff itself, taking an ordinary business deduction for each payment. However, in doing so, plaintiff would remain a mere general creditor.[65] Unfortunately, if defendant becomes insolvent under these conditions, plaintiff would be forced to stand in line with other creditors.[66] Section 130 changes that by encouraging defendants to pay the principal amount to an insurance company, hopefully a responsible one.[67] Thereafter, defendant's financial position is of no concern to plaintiff. Moreover, changes to the Tax Code in 1988 allow for structured settlement payees to have rights beyond those of a general creditor.[68]

Of course, there is another, perhaps more significant benefit to defendants. Defendants and their liability insurers can save anywhere between 10% and 30% by using a structured settlement.[69] This will be discussed in Part III.

Perhaps the simplest way to quantify the value of the tax exemption[70] is to compare the rate-of-return that a lump-sum investment would have to obtain, before taxation, in order to result in the same

64. See id.; JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

65. Risk, Structured Settlements, supra note 19, at 875.

66. Id.

67. Some have also observed that life insurance companies benefit from the tax treatment. 1999 Hearing, supra note 15, at 28 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) ("[A] Life Insurance Company gets to sell their annuity policies at very competitive rates. In turn, they put that money to work on investments earning large returns for themselves which far exceed the rate at which the annuities were placed. . . . It is not difficult to see the large profits the Life Insurance Companies enjoy . . . ."); Rudnitsky & Blyskal, supra note 9, at 29 ("Life Insurance Co. of North America isn't hurting either. Its payments guarantee an 8% return, but with long-term Treasury bonds now selling for 12%, LINA can actually do far better.").

68. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342, 3709–10 (1988).

69. Scales, supra note 2, at 880; see 1999 Hearing, supra note 15, at 28 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting savings of 15% to 20%); Neff E-mail, Feb. 23, 2009, supra note 32 (reporting a generally used estimate of 20% as a value of the tax subsidy).

70. At this point, we assume that defendant pays the same amount to the structured settlement company as it would to the plaintiff in a lump-sum settlement. We do so in order to quantify the entirety of the benefit. However, the benefit is likely shared by both parties. See infra Part IV.

after-tax rate-of-return of a structured settlement annuity.[71] As seen in the table below, a lump-sum settlement recipient in the 28% income tax bracket would have to invest at a 6.94% rate-of-return[72] in order to obtain the earnings that a structured settlement recipient would obtain by using an annuity with a rate-of-return of only 5%.[73]

TABLE 1: COMPARISON OF LUMP-SUM INVESTMENT RATE-OF-RETURN WITH AFTER-TAX RATE OF RETURN FOR STRUCTURED SETTLEMENT ANNUITY[74]

Structured Settlement Internal Rate of Return	15% Tax Bracket	28% Tax Bracket	33% Tax Bracket	35% Tax Bracket
5.00%	5.88%	6.94%	7.46%	7.69%
6.00%	7.06%	8.33%	8.96%	9.23%
7.00%	8.24%	9.72%	10.45%	10.77%
8.00%	9.41%	11.11%	11.94%	12.31%

71. Were a lump-sum to be invested as an annuity, the earnings would be taxed pursuant to section 72. I.R.C. § 72 (2006) ("[G]ross income includes any amount received as an annuity."). The earnings would be taxed according to the tax bracket of the taxpayer. I.R.S. Priv. Ltr. Rul. 2005-37-043 (June 23, 2005) ("Under section 72 of the Internal Revenue Code, any amount received under an annuity contract is taxable as ordinary income except to the extent it represents a return of your previously taxed investment in the contract."); I.R.S. Priv. Ltr. Rul. 2000-30-013 (July 28, 2000) ("In general, section 72 provides that distributions under an annuity contract will be taxed as ordinary income, subject only to reducing the taxable portion of the payments by an amount attributable to the annuitant's investment in the contract.").

72. This assumes that the investment is taxed at the ordinary income tax rate, which would be the case if the taxpayer invested in an annuity. See supra note 71. The table provided is based on investments in a bank's certificate of deposit, or CD. MATT GARRETSON & GUY KORNBLUB, NEGOTIATING AND SETTLING TORT CASES § 18:7 (2009). NSSTA provides a comparison where $100,000 structured settlement and $100,000 lump-sum investment produce similarly scheduled payments. Assume a federal income tax rate of 27%, a state income tax rate of 5%, an equal growth interest rate of 6%, and that the structured settlement pays out $500 per month for living expenses over twenty years. Under that scenario, NSSTA projects that the structured settlement will payout approximately $214,000, while the lump-sum will only net approximately $160,000. National Structured Settlements Trade Association, Taxable Portfolio vs. Tax-Free Structured Settlement, http://www.nssta.com/i4a/pages/index.cfm?pageid=3501 (last visited Jan. 20, 2009).

73. GARRETSON & KORNBLUB, supra note 72, § 18:7. The then president-elect for the trade association in Austin, Texas said that a structured settlement with a 6 or 7% rate-of-return for someone in the 40% tax bracket equates to the same earnings as a taxed rate-of-return at 11%. A Roundtable, supra note 10, at 79 (comments of Herb Cumming); Amy J. Conner, Structured Settlements: The Basics, LAWYERS WEEKLY USA, Aug. 6, 2001, at 2, available at http://www.jmwsettlements.com/structured_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf.

74. GARRETSON & KORNBLUB, supra note 72, § 18:7; 4Structures.com, Taxable Equivalent Yield Chart, http://www.4structures.com/4structures/front/resources/tem-

Even those in the 15% tax bracket can earn an additional 1% interest on investments. Over a period of many years, that amounts to a substantial increase in total wealth. Of course, the exemption is more valuable for those with higher tax rates.[75] However, those in the industry believe that the majority of claimants are net taxpayers.[76] Thus, it can benefit most claimants.

II.
STRUCTURED SETTLEMENTS: BIRTH, SUBSIDY, JUSTIFICATION, AND DOCTRINE

Many point to 1968 as the first year of structured settlements.[77] Not until the late 1970s and early 1980s did the method begin to grow at exponential rates.[78] The increasing use of structured settlements, rather than lump-sum payments, has been called "one of the most striking developments in the tort payment structure."[79]

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plate/resources_tools_taxable-equivalent-yield-structured-settlement.jsp (last visited Apr. 13, 2009) (providing the same statistics as the Garretson treatise, and more). One NSSTA attorney agrees that the table illustrates the increase in value that one can obtain through the tax subsidy. E-mail from Craig H. Ulman, Counsel to NSSTA to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 14, 2009 11:44:22 EDT) (on file with author). However, he correctly observes that the table compares a structured settlement annuity's performance with that of a CD, which cannot produce the same type of scheduled payments. Id. (noting that for this reason the comparison may be "poor"). Of course, the return rates listed may be somewhat high for the current economic climate.

75. See Rudnitsky & Blyskal, supra note 9, at 29 (quoting attorney Fred Levin) (describing how the exemption would prevent a 70% income tax rate from transforming 15% interest earnings on an invested lump-sum into 4.5%).

76. Neff E-mail, Feb. 23, 2009, supra note 32. Contra E-mail from Joseph Tombs, Partner, Amicus Financial Advisors LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (June 10, 2009, 8:57:37 EST) (on file with author) (estimating that 30% of structured settlement recipients actually receive a significant reduction in their future income taxes). One commentator questions such statistics: "Where is the objective proof? Many structured settlement industry 'beliefs' don't square with the facts." Hindert E-mail, Sept. 4, 2009, supra note 45 (citing Babener, supra note 2).

77. See Brian Brown & Lisa Chalidze, Structured Settlements: An Overview, 22 VT. B.J. & L. DIG. 14, 14 (1996); Thomas C. Downs, Superfund Colloquium: Periodic Payment of Claims: New Hope for CERCLA Settlements?, 8 TUL. ENVTL. L.J. 387, 402 (1995) (citing Panel Discussion, Annuities to Settle Cases, 42 INS. COUNS. J. 367, 370–77 (1975)). But see Riccardi & Ireland, supra note 15, at 7 (suggesting that it was only in 1968 that they became "widely used"); Brown & Chalidze, supra, at 14 (suggesting that the structured settlements were merely "given a boost" by the Thalidomide cases).

78. See infra Part II.A.

79. Ellen S. Pryor, Symposium, Liability for Inchoate and Future Loss, 88 VA. L. REV. 1757, 1763 (2002).

This section narrates the beginnings of structured settlements, their initial tax treatment by the IRS, and the subsequent legislation codifying and expanding their favorable treatment. In doing so, the section takes note of the initial belief that the doctrines of constructive receipt[80] and economic applied benefit.[81] These doctrines demand that structured settlement recipients, in order to take advantage of the beneficial tax treatment, not obtain control over the annuities purchased to fund their payments. The importance assigned to these doctrines corresponds with the legislation's presumed, and later declared justification to discourage personal injury claimants from quickly dissipating awards or settlement monies within their control.

Part III will then detail the eventual deconstruction of these two doctrines as applied to structured settlements.

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80. Tax regulations supply a definition of constructive receipt:

> Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Treas. Reg. § 1.451-2(a) (as amended in 1979) (emphasis added).

81. In Sproull v. Commissioner, the Tax Court found that despite an employee's non-involvement in the creation of a trust that deferred payments from the employer to a later date, the question was only whether "any economic or financial benefit [was] conferred on the employee as compensation." Sproull v. Comm'r, 16 T.C. 244, 247 (1951), aff'd, 194 F.2d 541 (6th Cir. 1952) (citing McEwen v. Comm'r, 6 T.C. 1018 (1947)). The court found that the fund was

> ascertained and paid for by petitioner's employer for his benefit in that year. Petitioner had to do nothing further to earn it or establish his rights therein. . . . No one else had any interest in or control over the monies. The trust agreement contained no restriction whatever on petitioner's right to assign or otherwise dispose of the interest thus created in him.

Id. at 248. Thus, the transfer of funds into the trust was held to be taxable income of the employee. Id. at 247–48. Several court's since have used the Sproull approach. A later Tax Court defined the doctrine: "Under the economic-benefit theory, an individual on the cash receipts and disbursements method of accounting is currently taxable on the economic and financial benefit derived from the absolute right to income in the form of a fund which has been irrevocably set aside for him in trust and is beyond the reach of the payor's debtors." Pulsifier v. Comm'r, 64 T.C. 245, 246 (1975) (citing Sproull, 16 T.C. at 247–48). In 1993, the economic benefit doctrine was applied in a technical advice memo to hold, "a service recipient's creation of a fund in which a service provider has vested rights will result in immediate inclusion of the amount funded in the service provider's gross income." I.R.S. Priv. Ltr. Rul. 93-36-001 (May 12, 1993). Some commentators, however, have argued that the economic benefit doctrine has been eroded through misapplication. See Gordon T. Butler, Economic Benefit: Formulating a Workable Theory of Income Recognition, 27 SETON HALL L. REV. 70, 103, 115 (1996).

A. The Birth and Growth of Structured Settlements

Though commentators have yet to determine who coined the term "structured settlements," many point to a set of Canadian Thalidomide cases,[82] against the drug manufacturer Richardson-Merrill.[83] Plaintiffs argued that the company's sleeping pill caused severe and permanent physical handicaps in the children of women who used it during pregnancy.[84] To settle the case, defendant agreed to make periodic payments to plaintiffs.[85] The subsequent rise of structured settlements in the next decade has been attributed to different triggers. Among them, some point to the increase in personal injury cases,[86] specifically "mass personal injury" cases.[87] As will be seen, the tax treatment was probably the largest factor.

As of 1976, the structured settlement market was worth approximately $5 million.[88] This quickly changed with IRS rulings in 1979 and congressional action in 1982,[89] discussed in Part I.B–C. Over the next quarter century, the structured settlement market grew rapidly.

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82. See Brown & Chalidze, supra note 77, at 14 ("Structured settlements as a means of resolving lawsuits date back to the 1960s, and were given a boost by the massive litigation triggered by the drug thalidomide . . . .").

83. Kenneth K. Keene & Robert J. Ross, Structured Settlements, BUS. INS., Apr. 28, 1980, at 25; Downs, supra note 41, at 402–04 (citing Panel Discussion, Annuities to Settle Cases, 42 INS. COUNS. J. 367, 370–77 (1975)).

84. Downs, supra note 41, at 402 (citing Panel Discussion, Annuities to Settle Cases, 42 INS. COUNS. J. 367, 370–77 (1975).

85. See Brown & Chalidze, supra note 77, at 14.

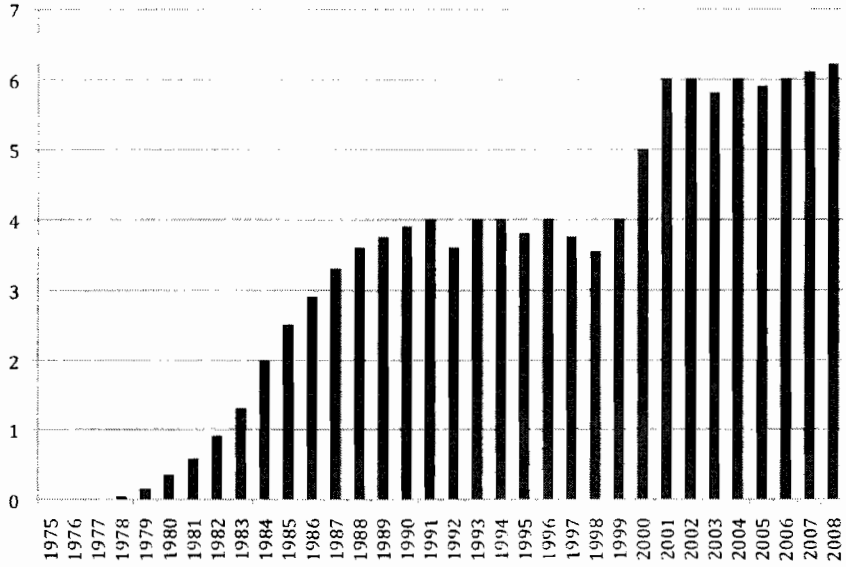
86. REPORT ON PERIODIC PAYMENT OF DAMAGE FOR PERSONAL INJURY AND DEATH, MANITOBA LAW COMMISSION 39 (1987).

87. Andrada, supra note 36, at 467 (citing Brown & Chalidze, supra note 77, at 14).

88. Riccardi & Ireland, supra note 15, at 8.

89. See Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75; Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605, 2605 (1983).

FIGURE 1: STRUCTURED SETTLEMENT ANNUITY SALES IN BILLIONS OF DOLLARS[90]



From $5 million in 1976,[91] and fewer than 3,000 cases in 1979, the market expanded to $1.5 billion in 1983, spread over 15,000 cases.[92] By the early 1990s, twenty life insurance companies were selling structured settlement annuities,[93] and the market had grown to $4 billion.[94] In 1997, a large survey found that 12% of commercial liability physical injury claims settled by way of structured settle-

90. The data was provided by Structured Financial Associates, Inc. E-mail from Melissa Evola, Vice President of Business Development, Structured Financial Associates, Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 27, 2009, 17:19:10 EST) (on file with author) [hereinafter Evola E-mail]. Their data incorporates data through 2002 from a structured settlement treatise, DANIEL W. HINDERT ET AL., STRUCTURED SETTLEMENTS AND PERIODIC PAYMENT JUDGMENTS § 1.03[1] (2009), and has been the treatise's source thereafter. Evola E-mail, supra.

91. Riccardi & Ireland, supra note 15, at 8.

92. Phillip L. Kennerly, Structured Settlements: A Useful Tool for the Claims Judge Advocate, 1986 ARMY L. 12, 12 n.3 (1986) (citing Denninger, Bellamy & Terue, Anatomy of a Structured Settlement, CASE & COMMENT, Feb. 1985, at 26). Other estimates put the value at over $2 billion in 1982. Kennerly, supra, at 128 (quoting Staller, The Basics of Structured Settlements, PRAC. LAW., Jan. 15, 1984, at 75). Some attribute their popularity in the early 1980s, at least in part, to annuities' then impressive double-digit rates-of-return. Risk, Structured Settlements, supra note 19, at 877.

93. Downs, supra note 41, at 403 n.83 (citing Structured Settlements; How to Make Sure You Don't Lose in 'Win-Win' Deals, BUS. INS., Nov. 25, 1991, at 25).

94. Risk, Structured Settlements, supra note 19, at 878.

ments.[95] Nearly 25% of the claims in excess of $300,000 involved structured settlements.[96] Based on the available statistics,[97] the average value of a structured settlement annuity premium is approximately $177,000.

In 2002, NSSTA reported $6.12 billion in annuity premium sales by its members.[98] By 2004, NSSTA estimated that over $400 billion of structured settlement payouts had already been made to 500,000 structured settlement recipients.[99] An organization that has tracked the growth of the industry reports that over 35,000 structured settlement annuities were sold in 2008,[100] accounting for $6.2 billion.[101] Some estimate that more than $100 billion of previously structured settlements currently exist.[102]

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95. ISO SURVEY, supra note 13, at 22.

96. See id. Reportedly, a NSSTA survey found that 7% of settlements between $75,000 and $100,000, and 30% of settlements over $1 million, use structured settlements. Hindert, supra note 16.

97. See Hindert, supra note 16 (providing the estimated total number of structured settlements, which can be used to calculate the average value of structured settlements when combined with the annual value of total structured settlement annuity premiums).

98. Risk, A Case, supra note 7, at 644 n.13 (citing Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003)); cf. Scales, supra note 2, at 882 n.72 (citing Press Release, National Structured Settlements Trade Association, Structured Settlements Industry Reports 19 Percent Surge in Demand During 2001; $6.05B Is Best Year in History (Feb. 5, 2002)).

99. HINDERT ET AL., supra note 90, § 1.03[1] (citing Report of National Structured Settlements Trade Association President Mal Deener to NSSTA Annual Meeting (May 1, 2004)).

100. Evola E-mail, supra note 90. In 2001, 50,000 to 60,000 tort claims were settled using structured settlements. Scales, supra note 2, at 882. It is unclear if that number is accurate, as the author has not found sources tracking the number of sales prior to 2008. If the 50,000 to 60,000 number is accurate, there is a real question of why the number has decreased to 35,000 while the value of sales have increased.

101. Evola E-mail, supra note 90. In the past, some have estimated the value to reach some $10 billion, 1999 Hearing, supra note 15, at 78 (written statement of J.G. Wentworth, a finance company that purchases and securitizes structured settlements), or even $12 billion. Riccardi & Ireland, supra note 15, at 8 (citing http://www.nssta.com). AIG sold the most structured settlement annuities, with nearly $1.5 billion. Evola E-mail, supra note 90. After AIG comes Prudential, with $986 million, MetLife, with $857 million, Hartford, with $767 million, Aviva, with $504 million, John Hancock, with $489 million, New York Life, with $361 million, Allstate, with $280 million, Pacific, with $274 million, Liberty, with $240 million, and Symetra, with $14 million. Id. One treatise notes that the steady volume of structured settlements "indicates a mature market." HINDERT ET AL., supra note 90, § 1.03[1].

102. See, e.g., Daniel W. Hindert & Craig H. Ulman, Transfers of Structured Settlement Payment Rights: What Judges Should Know About Structured Settlement Protection Acts, 44 JUDGES' J. 19, 19 (2005).

It seems to be roundly agreed upon that "[t]he $6,000,000,000 market for structured settlement annuities owes its existence almost entirely to the tax subsidy."[103]

B. The Two Revenue Rulings that Changed Everything

The tax treatment of structured settlements was initially established in 1979.[104] The IRS issued two revenue rulings interpreting section 104(a)(2) in relation to structured settlements, Rev. Rul. 79-220,[105] and Rev. Rul. 79-313.[106] Each allowed the exclusion of periodic payments for personal injury settlements.[107]

Rev. Rul. 79-220 permitted a plaintiff to exclude from income the nominal value of periodic settlement payments when received, rather than their discounted present value at the time of the settlement.[108] In deciding, the ruling took specific note of the fact that the settlement did not give any rights to the plaintiff in the annuity purchased by defendant's insurer.[109] Ultimately, the plaintiff neither had "actual [n]or constructive receipt [n]or the economic benefit of the lump-sum amount that was invested to yield [the monthly settlement payments]."[110] The ruling likened the situation to that of an employer providing deferred compensation.[111] There as well, "the arrangement [is] merely a matter of convenience to the obligor and [does] not give the recipient any right in the annuity itself."[112]

Rev. Rul. 79-313 permitted a plaintiff to exclude from income annual payments made pursuant to a settlement agreement, regardless of the fact that the payment amounts increased by a set percentage each year.[113] Of central importance was the fact that the taxpayer had "neither actual nor constructive receipt, nor the economic benefit of the present value of the damages."[114] Having received neither control

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103. Scales, supra note 2, at 895 (citing A Roundtable, supra note 10, at 72 (comments of Charles Krause); 1999 Hearing, supra note 15, at 24–25 (Statement of Timothy J. Trankina, Chief Executive Officer, Peachtree Settlement Funding)); cf. Meligan Interview, supra note 31 (suggesting that fewer structured settlements would occur without the tax benefits).

104. See Riccardi & Ireland, supra note 15, at 8.

105. See Rev. Rul. 79-220, 1979-2 C.B. 74.

106. See Rev. Rul. 79-313, 1979-2 C.B. 75.

107. See Rev. Rul. 79-220, 1979-2 C.B. 74; see Rev. Rul. 79-313, 1979-2 C.B. 75.

108. See Rev. Rul. 79-220, 1979-2 C.B. 74.

109. See id.

110. Id. (emphasis added).

111. See id. (citing Rev. Rul. 72-75, 1972-1 C.B. 127).

112. Id. (citing Rev. Rul. 72-75, 1972-1 C.B. 127).

113. See Rev. Rul. 79-313, 1979-2 C.B. 75.

114. Id. (emphasis added).

nor guaranteed benefit of the future payments, a taxpayer need not include such monies in their taxable income. Thus, again we see the application and significance of the two doctrines.

C. Codification and More

Structured settlements increased in usage after 1979, as noted, but defendants purchasing annuities to make the periodic payments were only able to deduct those payments as business expenses as the money was distributed to plaintiffs.[115]

In an attempt to alter this disadvantageous position, and thus make structured settlements more attractive to casualty and liability insurers, IBAR Inc. hired a lobbyist, David M. Higgins, a Los Angeles tax attorney, to persuade Congress to enact legislation providing such a deduction.[116] Mr. Higgins worked with the IRS to draft such a law, as well as the Congressional Budget Office.[117] The bill was intro-

115. See Risk, Structured Settlements, supra note 19, at 873–74.

116. Id. at 874. IBAR Settlement Co., Inc. was advised that even if the legislative attempt failed, it would show that there had been a good faith effort to clarify the issue. E-mail from Stan Schultz, CEO, IBAR Settlement Co., Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 27, 2009, 21:05:01 EST) (on file with author) [hereinafter Schultz E-mail].

117. Risk, Structured Settlements, supra note 19, at 874. IBAR first approached Congressman Barry Goldwater, Jr. Schultz E-mail, supra note 116. However, Congressman Goldwater, Jr. was soon embroiled in a drug scandal. Id. See generally House Drug Query Is Assailed, N.Y. TIMES, Nov. 19, 1983, at § 1. Thereafter, IBAR hired the firm of Manett, Phelps, and Phillips, which provided former Congressman James Corman to lobby the "IBAR Bill." Schultz E-mail, supra note 116. At the same time, a group of structured settlement brokers attempted to secure a private letter ruling on similar issues. Id. Though they were advised by the IRS to withdraw the request, they did not. Id. Thereafter, an adverse private letter ruling was issued. Id.; see I.R.S. Priv. Ltr. Rul. 82-48-073 (Aug. 31, 1982). Interestingly, a private letter ruling issued two years prior had already secured the substance of what the 1982 ruling decided against, and what the subsequent legislation would soon codify. See I.R.S. Priv. Ltr. Rul. 80-38-044 (June 24, 1980) (finding a transfer of funds to a structured settlement company equivalent to a loan transaction, and thus not taxable). Though there was no opposition to the original contents of the bill, its many unrelated amendments prevented passage in its first form as the Periodic Payment Settlement Act of 1981. Schultz E-mail, supra note 116. In fact, it was referred to in Congress as "The Christmas Tree Bill," an initially uncontroversial bill that attracted amendments because congressmen believed it would pass. Id. Before passing H.R. 5470 on October 1, 1982, 128 CONG. REC. S26,905 (1982) (statement of the Presiding Officer), the Senate attached to it five "nongermane amendments." 128 CONG. REC. H30,352 (1982) (statement of Rep. Rostenkowski) (noting amendments concerning the Highway Trust Fund, the Hawaiian Prepaid Health Care Act, and tax-related amendments concerning foster care payments, Indian tribal governments, and income in the Virgin Islands). Before submitting the bill to Conference, the House attached a non-germane amendment of its own. 128 CONG. REC. H30,352 (1982) (clarifying government responsibilities in regulating "multiemployer health trusts"). The Conference report, agreed to by both houses soon after its release, 128 CONG. REC. H33,263

duced separately by several legislators.[118]

The Periodic Payment Settlement Tax Act of 1982 codified the two 1979 revenue rulings[119] by amending section 104(a)(2), but went further, creating section 130.[120] Interestingly, Congress avoided providing substantive justifications.[121] Moreover, Congress repeated its evasion when amending the law in 1988,[122] 1996,[123] and 1997.[124]

The Periodic Payment Settlement Tax Act of 1982 codified what the previous revenue rulings provided, replacing section 104(a)(2)'s personal injury exclusion language of "whether by suit or agreement" with "whether by suit or agreement and whether as lump sums or as periodic payments."[125] Reports by the Senate Finance Committee and House Committee on Ways and Means cited the benefit to taxpayers of providing "statutory certainty,"[126] even though parallel revenue rulings already existed. They also stated that the provision was "intended to codify, rather than change, present law . . . [and that] periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive re-

(1982); 128 CONG. REC. S33,183 (1982), cut the House's amendment and two of the Senate's amendments, but generally agreed to the remaining three. See H.R. REP. NO. 97-984, at 13–21 (1982) (Conf. Rep.); see also 128 CONG. REC. H33,263 (1982) (statement of Rep. Rostenkowski) (referring to the Senate amendments respecting Indian tribal governments, the Hawaiian Prepaid Health Care Act, and the tax treatment of particular foster care payments). After trimming and passage, President Reagan intended to veto the bill. See Schultz E-mail, supra note 116 (recalling that the Indian tribal governments amendment was of concern to the President). However, former Congressman James Corman lobbied House Speaker Tip O'Neil, who successfully lobbied the President. Id. Thus, the "IBAR Bill" was signed into law. Id.

118. H.R. 5470 was substantively identical to H.R. 4356, introduced by Congressmen Goldwater and Rousselot, and H.R. 5732, introduced by Congressman Holland. JOINT COMM. ON TAXATION, 97TH CONG., DESCRIPTION OF TAX BILLS (H.R. 4467, H.R. 4948, H.R. 5177, H.R. 5470, AND H.R. 5573 12 n.1 (Comm. Print 1982)). H.R. 4356 and H.R. 5732, unlike H.R. 5470, would have taken effect earlier. Id.

119. See Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75; see also JOINT COMM. ON TAXATION, 97TH CONG., DESCRIPTION OF TAX BILLS (H.R. 4467, H.R. 4948, H.R. 5177, H.R. 5470, AND H.R. 5573 12-13) (Comm. Print 1982).

120. See generally Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, 96 Stat. 2605.

121. See id.; see also S. REP. NO. 97-646 (1982).

122. See Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079, 102 Stat. 3709 (1988).

123. See Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605, 110 Stat. 1755, 1838 (1996); see also H.R. REP. NO. 104-586 (1996).

124. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 962(a), 111 Stat. 788, 891 (1997).

125. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605 (emphasis added).

126. H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 3 (1982).

ceipt of or does not have the current economic benefit of the sum required to produce the periodic payments."[127]

In addition to the codification, the Act inserted section 130 into the tax code, excluding from gross income amounts received by structured settlement companies for accepting a qualified assignment.[128] The addition was passed over certain objections by the Treasury[129] and the life insurance industry.[130]

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127. H.R. REP. No. 97-832, at 4 (1982) (emphasis added); S. REP. No. 97-646, at 3–4 (1982) (emphasis added).

128. See Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(b)(1), 96 Stat. 2605. See generally I.R.C. § 130 (2006). Fifteen years later, in response to lobbying by the National Structured Settlements Trade Association, see Risk, Structured Settlements, supra note 19, at 886 (citing Letter from Legislation and Regulations Committee, NSSTA, to NSSTA Member Companies (Apr. 1997)), the Taxpayer Relief Act of 1997 amended section 130, extending the exemption to worker's compensation payments. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 962(a), 111 Stat. 788, 891 (1997).

129. See Miscellaneous Tax Legislation: Hearings Before the Subcomm. on Select Revenue Measures of the Comm. on Ways and Means, 97th Cong. 7 (1982) [hereinafter 1982 Hearing] (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Treasury Department) (objecting because "[o]ur reading is that it goes beyond existing law"). Because structured settlement annuity earnings would neither be taxable to defendant or plaintiff, Treasury argued that "income slips through the system." Id. at 7. In doing so, Treasury believed the bill to create "a substantial new benefit to third parties that assume obligations to make periodic damage payments." Id. at 14 (written statement of John E. Chapoton). Having heard Treasury testimony, Committee Chairman Pete Stark transitioned to the next witness: "I am sure the gentlemen will now proceed to destroy the testimony of the Secretary of the Treasury. You may proceed to do that in any manner you see fit." Id. at 81 (statement of Pete Stark, Chairman of the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means). IBAR Settlement Co., Inc. lobbyist later responded to the Treasury statements: "I think the Treasury has misread [this] bill . . . I am hopeful we can work out with Treasury their objections because we certainly are not in here looking for anything special. We do not want any excess deductions and we do not want any extraordinary exclusions . . . ." Id. at 88–89 (written statement of David M. Higgins, Esq., Overton, Lyman, & Prince). Interestingly, no one pointed to the previously discussed 1980 private letter ruling holding that monies transferred to a structured settlement company were excludable as the equivalent of a loan transaction. See I.R.S. Priv. Ltr. Rul. 80-38-044 (June 24, 1980). A contrary ruling in 1982 was also not discussed. See I.R.S. Priv. Ltr. Rul. 82-48-073 (Aug. 31, 1982).

130. 1982 Hearing, supra note 129, at 113 (statement of the American Council of Life Insurance) ("Specifically, we are troubled by the provision of the bill which allows such assignees an exclusion from income for amounts received and applied to satisfy assumed damage obligations, yet does not in any way specify when, or how, the assignee must use the amounts received to fund the damage payments . . . . [W]e can see no justification for giving free rein to entities not subject to the rigorous solvency and reserve accounting standards applicable to insurers to provide such statements . . . . For these reasons, we urge that H.R. 5470 be withdrawn, at least insofar as it specifies the tax treatment to be given third party payors of structured annuity damage amounts.").

D. Extrapolating a Justification from the Legislative History

While the committee reports for the Periodic Payment Settlement Tax Act of 1982 convey little about Congress's preference between structured settlements and lump-sum settlements, allowing for both, legislative history of the Act's 1981 predecessor and the 1982 Act's committee hearing provide insight. Concern for the "Squandering Plaintiff,"[131] one who accepts a lump-sum and prematurely dissipates it, was frequently cited. The justification fits well alongside the reference to the constructive receipt and economic benefit doctrines, which require that a claimant not control received settlement monies. By preventing such control, premature dissipation becomes difficult, if not impossible.

Prior to introducing the Periodic Payment Settlement Tax Act of 1982,[132] Senator Max Baucus[133] introduced a very similar Periodic Payment Settlement Act of 1981.[134] Senator Baucus argued that the lump-sum settlement approach "has proven unsatisfactory . . . in many cases because it assumes that injured parties will wisely manage large sums of money so as to provide for their lifetime needs. In fact, many of these successful litigants, particularly minors, have dissipated their awards in a few years and are then without means of support."[135] In contrast, he went on, structured settlements "provide plaintiffs with a steady income over a long period of time and insulate them from pressures to squander their awards."[136]

One year later, in Committee hearings on the bill for the 1982 Act, similar assertions of plaintiff irresponsibility were introduced by Patrick J. Hindert,[137] the later author of a leading structured settlement

131. See Scales, supra note 2, at 869 (discussing this oft-cited argument).

132. See 144 CONG. REC. S11, at 499–01 (1998) (statement of Sen. Baucus).

133. Max Baucus is currently Montana's Senior U.S. Senator, and Chairman of the Senate Finance Committee. See Max Baucus Newsroom, http://baucus.senate.gov/?p=newsroom (last visited Feb. 1, 2009).

134. See The Periodic Payment Settlement Act of 1981, S. 1934, 97th Cong. (2d Sess. 1981).

135. 127 CONG. REC. 30,462 (Dec. 10, 1981) (statement of Sen. Baucus) (introducing the Periodic Payment Settlement Act of 1981).

136. Id.

137. See 1982 Hearing, supra note 129, at 82, 84 (statement of Patrick J. Hindert, President of Benefit Designs, Inc., a consulting firm for personal injury case parties) (testifying that lump-sum plaintiffs "are frequently back on the public dole" due to the dissipation of their award, and that lump-sum recipients are "frequently ill-equipped psychologically, physically or educationally to assume the investment and mortality risks associated with managing money to satisfy anticipated future financial requirements").

treatise,[138] and David Higgins,[139] the attorney hired by IBAR Settlement Co., Inc., to lobby Congress.[140]

The legislative history for the Periodic Payment Settlement Tax Act of 1982 suggests that the prematurely dissipating plaintiff was a, if not the primary, justification for the legislation. This was true even though structured settlement annuities are subject to risks of inflation[141] and insurer failure.[142] Senator Baucus, Mr. Hindert, and Mr. Higgins each suggested that the problem of lump-sum dissipation ex-

138. See generally HINDERT ET AL., supra note 90.

139. See 1982 Hearing, supra note 129, at 87 (written statement of David M. Higgins, Esq., Overton, Lyman, & Prince) ("The use of a periodic payment settlement assures the availability of future compensation for lost support and care as those costs are incurred. Plaintiffs receiving periodic payments truly are protected from their own ill-conceived actions and the advice of others. If a payment or several payments are dissipated, future compensation for future costs continues to be available . . . . The payment of a substantial lump sum often does not mitigate those economic losses in the long run, even if the amounts are theoretically adequate, because few people are capable of investing a large lump sum to assure security, liquidity, and an appropriate rate of return for their future needs. They often are ill-advised by friends, relatives, and even professional managers, and some are natural spend-thrifts in any event.").

140. Telephone Interview with Stan Schultz, CEO, IBAR Settlement Co., Inc. (Apr. 8, 2009).

141. An annuity requires a payee to bind oneself to set future periodic payments. Some have criticized such binding because the plaintiff risks the possibility that inflation will be higher than estimated. See, e.g., Riccardi & Ireland, supra note 15, at 12; see also J. Thomas Romans & Frederick G. Floss, Structured Settlements and the Interest Rate Switch, 12 J. FORENSIC ECON. 57, 60 (1999); Yandell, supra note 50, at 73. If so, the value of the annuity payments decrease, and the annuity cannot be converted into other investments. See Joseph Kelner & Robert S. Kelner, Trial Practice, Variable Income Annuity Structured Settlements, N.Y.L.J., June 27, 2000. Of course, the lack of future knowledge is a "two edged sword." Riccardi & Ireland, supra note 15, at 12. If the rate of inflation is lower than projected, the annuity's payments will have greater value. And, in fact, one study found the internal rates of structured settlements to historically outperform Treasury bill rates 78.52% of the time. See Romans & Floss, supra, at 64. It is unclear what occurs during the remaining 21.48% of the time. See id.

Some structured settlements do not account for inflation at all. See I.R.S. Priv. Ltr. Rul. 94-37-028 (Sept. 17, 1994) (ruling that inflation does not effect the structured settlement tax exemption). This places claimants at far greater risk of increases in inflation. Meligan Interview, supra note 31. One plaintiff-side structured settlement planner recommends not indexing a structured settlement annuity to inflation for clients over forty years of age. Id. This is because an indexed annuity's increasing nominal payments will often not reach the non-indexed payments of decreasing value for over twenty-five years, by which time a claimant will likely not have many years of payments left. Id.

One might ask why Congress allows claimants to risk the loss of their award or settlement by betting on low inflation. Mandating the indexing of structured settlement annuities to inflation might be more in line with the original purpose of the tax subsidy. On the other hand, the fear of the prematurely dissipating plaintiff might have been solely aimed at poor purchasing, not poor investing. This defense will be relevant in the next section as well.

isted, and required a solution. Interestingly, such rhetoric was not included in the committee reports.[143]

E. Congressional Justifications in Hindsight

Though the legislative history suggests that Congress's purpose was to discourage plaintiff lump-sum dissipation, commentators and courts had no congressionally adopted justifications to rely on.[144] Thus, for nearly two decades they hypothesized. Some suggested that periodic payments are excluded simply because personal injury damages are excluded,[145] others that Congress believed structured settlements would prevent plaintiffs from later government dependence.[146]

In 1998 and 1999, however, in the midst of considering how to discourage former plaintiffs from selling their structured settlement without court approval,[147] the justification question was addressed, and largely answered.

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142. One risk inherent to structured settlements is the possibility that the insurer making the periodic payments will not be able to pay, though this has not yet occurred. See Riccardi & Ireland, supra note 15, at 11. Though the 2008 crisis has brought fear and concern about bank security, structured settlements have several protections for payees. National Structured Settlements Association, supra note 57. Such companies must maintain assets above a required reserve ratio, though many reserve more. Id. State regulators retain authority to help move companies toward restructuring in the event of financial insecurity. Id. And, state insurance guaranty associations offer protection somewhat similar to the Federal Deposit Insurance Corporation, making some periodic payments possible if an insurance company stops making payments. Id. However, there are significant limitations in each state preventing insurance agents and brokers from publicly or privately using the existence of guaranty corporations to encourage the use of annuities. See, e.g., N.Y. INS. LAW § 7718 (Consol. 2009). The National Organization of Life & Health Insurance Guaranty Associations keeps a list of the various state statutes. NOLHGA, State Laws and Provisions Report, http://www.nolhga.com/factsandfigures/main.cfm/location/lawdetail/docid/18 (last visited Feb. 9, 2009). It is not clear if guaranty associations will insure factoring companies against life insurance company failures. See Bracy Interview, supra note 28. There has been recent movement toward specifically excluding factoring companies from such protections. See id. Structured settlement planners discuss the possibility of insurer failure with personal injury claimants, but the de minimis risk makes it a very positive discussion. See Meligan Interview, supra note 31.

143. See H.R. REP. NO. 97-832 (1982); S. REP. NO. 97-646 (1982).

144. It seems unlikely that "statutory certainty," see H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 4 (1982), led to the bill's passage. Inserting section 130 was not a codification.

145. Blackburn, supra note 61, at 685.

146. See, e.g., O'Connell, supra note 27; see also Mannix, supra note 27, at 62 ("In 1982, seeking to prevent accident victims from frittering away large sums intended to provide for them over their lifetimes, Congress instituted tax breaks for those who agreed to receive their money over a period of years.").

147. Cf. 1999 Hearing, supra note 15, at 6 (statement of Rep. Pete Stark); 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus).

Industry representatives from both the structured settlement companies and structured settlement purchasing companies agreed that the 1982 legislation was passed in response to the danger of premature lump-sum dissipation.[148] Several congressmen, including those involved in the passage of the original legislation, agreed.[149] Lastly, in describing the basis for what it called Congress's "tax subsidy for the use of structured settlement[s],"[150] the Joint Committee on Taxation report agreed.[151]

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148. 1999 Hearing, supra note 15, at 20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P, on behalf of the National Association of Settlement Purchasers) ("There is no question that one of the reasons motivating [the House Ways and Means Committee on Oversight] to adopt the Periodic Payment Settlement Act of 1982 was that structured settlements are useful in protecting people who cannot protect themselves."); see id. at 37 (statement of Thomas W. Little, Former President of National Structured Settlements Trade Association, on behalf of the NSSTA) ("Congress has adopted special tax rules to encourage and govern the use of structured settlements in order to provide long-term financial security for injured victims and their families.").

149. See id. at 5 (statement of Rep. Pete Stark) ("The stories of people who received large lump-sum settlements and squandered them were equally heart rending, some ended up back on welfare if they were in fact disabled. It made great good sense then, and I think it makes great good sense now."); id. at 6 (statement of Rep. E. Clay Shaw, Jr.) ("Congress was concerned that injured victims would prematurely spend a lump-sum recovery and eventually resort to the social safety net."); 144 CONG. REC. S11,499–01 (1998) (statement of Sen. Baucus) ("[O]ur focus in enacting these tax rules in sections 104(a)(2) and 130 of the Internal Revenue Code was to encourage and govern the use of structured settlements in order to provide long-term financial security to seriously-injured victims and their families and to insulate them from pressures to squander their awards.").

150. JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

151. Id. at 7 ("If a recipient chooses a lump sum settlement, there is a chance that the individual may, by design or poor luck, mismanage his or her funds so that future medical expenses are not met. If the recipient exhausts his or her funds, the individual may be in a position to receive medical care under Medicaid or in later years under Medicare. That is, the individual may be able to rely on Federally financed medical care in lieu of medical care that was intended to have been provided by the personal injury award. Such a 'moral hazard' potential may justify a subsidy to encourage the use of a structured settlement arrangement in lieu of a lump sum payment to the recipient, to reduce the probability that such individuals need to make future claims on these government programs. Under the structured settlement arrangement, by contrast to the lump sum, it is argued that because the amount and period of the payments are fixed at the time of the settlement, the payments are more likely to be available in the future to cover anticipated medical expenses (assuming the payment stream is not transferred by the recipient).") (emphasis added). While the language "may justify" could be interpreted to indicate a lack of commitment by the Joint Committee, the report strongly indicates agreement that the purpose of the subsidy is to prevent dissipation.

Thus, after nearly two decades, Congress had finally clarified the justification for the "tax subsidy" to structured settlement transactions, namely, the image of the squandering plaintiff.[152]

III.
ALLOWING CONSTRUCTIVE RECEIPT AND ECONOMIC BENEFIT

Though Congress's actions and writings discussed thus far highlighted the application of the constructive receipt and economic benefit doctrines to structured settlements, the late 1980s marked the beginnings of a complete overhaul. This section narrates the deconstruction of both doctrines, as applied to structured settlements, through two stages. Congress first legislated a reduced application of the economic benefit doctrine in 1988. Then, in the early 1990s, a new and profitable transaction was discovered whereby a company purchases a structured settlement recipient's future payments, thus conferring the substance of constructive receipt. The IRS and Congress implicitly confirmed recipients' ability to perform such a transfer.

The two changes substantively destroyed much of the constructive receipt and economic benefit doctrines as applied to structured settlements. On the surface, they seem to detract from Congress's initially presumed, now known justification for the structured settlement tax subsidy: the discouragement of personal injury claimants from prematurely dissipating lump-sums. However, though the changes transfer at least some control to the claimant, they leave the tax subsidy's effect intact. As will be shown, they may even have bolstered the subsidy's effectiveness.

A. Congress's U-Turn on Plaintiffs' Need to Avoid Economic Benefit

Though both revenue rulings and legislative history[153] highlight the importance of preventing plaintiffs from receiving the economic benefit of a structured settlement, that limitation was substantially eroded in 1988.[154]

Originally, section 130 stipulated "the assignee does not provide to the recipient of such payments rights against the assignee which are

152. See Scales, supra note 2, at 869 (discussing this oft-cited argument).

153. See H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 4 (1982); Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.

154. See Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A)–(B), 102 Stat. 3342.

greater than those of a general creditor."[155] Thus, a structured settlement recipient was merely a "general creditor"[156] to a structured settlement company, a person to whom the company owed future payments. However, Congress changed the language in 1988 to state, "The determination . . . of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor."[157] Thus, structured settlement plaintiffs can now obtain rights "greater than those of a general creditor."[158]

The new language in the 1988 amendment has been read by the IRS to override the doctrine of economic benefit:

> Generally, the setting aside of funds in trust for recipient confers an economic benefit and results in income to the recipient in the year of setting aside the funds. See Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952). However, the 1988 amendment to section 130(c) of the Code was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments.[159]

The IRS has since held that a plaintiff can hold a security interest in a bank trust created by defendant to fund plaintiff's periodic payments without violating sections 104(a)(2) or 130.[160] Today, some insurance companies offer agreements providing these greater rights, while others do not.[161]

As an explanation for the 1988 amendment, the House Report stated, "Recipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of tax law."[162] Thus, perhaps meaning to, or perhaps not,

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155. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(c)(2)(C), 96 Stat. 2605.

156. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605.

157. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342.

158. Id.

159. I.R.S. Priv. Ltr. Rul. 97-03-038 (Jan. 1, 1997) (emphasis added).

160. Id.; see also I.R.S. Priv. Ltr. Rul. 92-53-045 (Oct. 6, 1992) (holding that section 130 allows a plaintiff to perfect a security interest in a structured settlement annuity contract).

161. E-mail from Betty Gregware, Sales Executive, John Hancock Life Insurance Company to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 27, 2009, 12:47:07 EST) (on file with author).

162. H.R. REP. NO. 100-795, at 541 (1988). See generally H.R. REP. NO. 100-1104, at 25 (1988) (Conf. Rep.).

Congress took a large step away from the economic benefit doctrine as it applies to structured settlements.

Commentators vary in their interpretation of the 1988 switch. One author simply finds the failure to apply the economic benefit doctrine to periodic payments confusing, especially in light of contradictory application of the doctrine in analogous contexts.[163] Another argues that the doctrines of constructive receipt and economic benefit, as applied to structured settlements, should be narrowly construed.[164] At the very least, the 1988 amendment to section 130 allowed the payee of a structured settlement rights that the 1982 House[165] and Senate[166] reports stated would render the received payments ineligible for the favored tax treatment, thus violating the traditional understanding of the economic benefit doctrine.

However, the 1988 legislation did not necessarily contravene Congress's purpose in creating the structured settlement tax subsidy. The new rights available under the amendment can only be accessed under rare circumstances that, in fact, have never transpired.[167] If anything, the amendment assists the tax subsidy, encouraging personal injury claimants to engage in structured settlements by reducing the fear of losing one's settlement monies due to a defendant's bankruptcy. For purposes of this Article the important takeaway is that even early on Congress showed a willingness to relax the doctrine of economic benefit as applied to structured settlements.

B. Eroding Constructive Receipt Through Factoring

Though the 1988 amendment marked a departure from the original application of the economic benefit doctrine to structured settlements, a new transaction developed in the early 1990s that went even further, violating the traditional understanding of the constructive receipt doctrine.[168] The transaction, known as structured settlement

163. Frolik, supra note 55, at 581–82 (citing Rev. Rul. 62-74, 1962-1 C.B. 68 (holding prize payments that would be paid out over two years to be taxable in the year won, despite the fact that the prize money had been deposited into an escrow account prior to the contest); Pulsifier v. Comm'r, 64 T.C. 245, 245–47 (1975) (holding a cash prize taxable in the year won, though it would not be received by the minor winners until the age of majority)). Frolik argues that it seems far more plausible to apply the economic benefit doctrine to structured settlements than prizes not immediately redeemable, especially since structured settlement recipients often play a role in creating the terms and timing of the future payments. Frolik, supra note 55, at 581–582.

164. Risk, A Case, supra note 7, at 652.

165. See H.R. REP. NO. 97-832, at 4 (1982).

166. See S. REP. NO. 97-646, at 4 (1982).

167. Gregware Interview, supra note 17.

168. Scales, supra note 2, at 915.

"factoring," is the sale by a former claimant, now payee, of the right to their structured settlement's future stream of income[169] in exchange for a lump-sum payment.[170] The payee's received lump-sum has since been held to fall under section 104(a)(2), just as if paid in lump-sum form by the original defendant.[171] By offering a cash amount to a structured settlement recipient sufficiently below the present value of the future income stream, a factoring company[172] can net a profit. Commentators have observed that plaintiffs' newfound ability to convert their future structured settlement payments to present value at any time "bespeak[s] 'constructive receipt' of those payments."[173] Thus, in the early 1990s, the creation of the factoring industry tread over

169. The factoring industry reports that the vast majority of factoring transactions are partial purchases, performed by employed structured settlement owners long after the original settlement. 1999 Hearing, supra note 15, at 19–20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, LLP, on behalf of the NASP) (noting that the average seller of a structured settlement had a household income of nearly $25,000).

170. Scales, supra note 2, at 861 (also referring to factoring as "unstructuring"). Insurance companies selling structured settlement annuities frequently place anti-assignment clauses in their contracts. Gregory S. Crespi, Selling Structured Settlements: The Uncertain Effect of Anti-Assignment Clauses, 28 PEPP. L. REV. 787, 789 (2001). Anti-assignment clauses are typically not self-executing. Hindert E-mail, Sept. 4, 2009, supra note 45. A relevant party must act to enforce the clause, though this has become rare since the insertion of section 5891 into the Tax Code. Id. An evolving area of law is the question of whether or not such clauses are effective. See generally HINDERT ET AL., supra note 90, § 16.02[c]; Crespi, supra. However, some observe that anti-assignment clauses are generally not enforced today. See Hindert & Ulman, supra note 102; see Patrick D. Dolan, Securitization of Life Settlements, Structured Settlements and Lottery Awards, in NEW DEVELOPMENTS IN SECURITIZATION 2008 961, 967 (2008) ("Although State Transfer Acts do not explicitly address the enforceability of anti-assignment clauses, the procedures make it much less likely that the transfer will be attacked successfully."). But see C.U. Annuity Service Corp. v. Young, 722 N.Y.S.2d 236, 236–37 (N.Y. App. Div. 2001) ("[T]he promisee did not merely agree that he would refrain from making an assignment; he agreed he was powerless to do so. Having surrendered his legal ability to assign, there was no basis upon which he or any assignee could assert that a purported sale could have any legal effect."); HINDERT ET AL., supra note 90, § 16.02[2] ("[I]n the vast majority of cases, the courts have enforced anti-assignment provisions in structured settlement agreements."). In 1999, it was reported that the insurance industry "routinely file[d] 40 and 50 page briefs and objections to the transfers." 1999 Hearing, supra note 15, at 24 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

171. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999).

172. Though structured settlement recipients typically sell their future stream of income to factoring companies, they could also sell the stream to the original structured settlement company or life insurance company. See Settlement Capital Corp. v. BHG Structured Settlements, Inc., 319 F. Supp. 2d 729, 732 (N.D. Tex. 2004) (concerning a tortious claim where a factoring company lost a purchase of periodic payments from a structured settlement recipient, who decided to transfer her future payments to the annuity-originating structured settlement company instead of the factoring company).

173. Scales, supra note 2, at 915.

Congress's original understanding of section 104(a)(2)'s exclusion limitations.

The factoring market began in the early 1990s.[174] The Settlement Capital Corporation describes itself as the first factoring company.[175] Jim Lokey, the corporation's founder, created the business model after responding to a structured settlement recipient's classified advertisement in a local paper, offering to sell the right to future payments.[176] Soon, other companies entered the market, such as J.G. Wentworth, Peachtree Funding, and Singer Asset Finance.[177] By 1997, at least five major settlement purchasers and many small brokers joined the fray.[178] By 2005, it was estimated that some $250 million of structured settlement payments were purchased annually.[179] J.G. Wentworth, the self-proclaimed "leading direct-to-consumer purchaser of illiquid insurance products issued by highly rated financial institutions in the United States,"[180] reports purchasing structured settlements with aggregate payment streams of $728 million in both 2007 and 2008.[181] Since its inception, the company has completed over 51,000 factoring transactions, with aggregate payment streams of nearly $4 billion.[182] Currently, it is estimated that approximately 8,000 factoring transactions occur annually, with an average price of $45,000, amounting to $360 million.[183] Based on the estimated value

174. Mannix, supra note 27, at 62; O'Connell, supra note 27. But see Settlement Capital Corporation, Structured Settlement Factoring, http://www.setcap.com/structuredfactoring.aspx?pt=services&mCATEGORY_ID=84&SubCATEGORY_ID=84 (last visited Feb. 19, 2010).

175. Settlement Capital Corporation, supra note 174.

176. Scales, supra note 2, at 898 (citing Interview with Earl Nesbitt, Vice President and General Counsel, Settlement Capital Co., in Halladale, Fla. (Oct. 29, 2001)).

177. Scales, supra note 2, at 900. To expand his business, Lokey encouraged structured settlement insurers, consultants, and brokers to refer clients in need of upfront cash to Settlement Capital Corp. Bracy Interview, supra note 28. In doing so, he taught his soon-to-be competitors how to factor. Id.

178. HINDERT ET AL., supra note 90, § 16.02[1] (citing Selling Structured Settlement Payments, NSSTA Newsletter, 3 (Jan. 1998). Other companies, such as Berkshire Hathaway Life Insurance Co., later entered the market. Mannix, supra note 27, at 62. Though there used to be a great many brokers, they are now few and far between. Bracy Interview, supra note 28. Many of the factoring brokerage companies are now factoring companies. Id.

179. See HINDERT ET AL., supra note 90, § 16.02[2].

180. Disclosure Statement: Prepetition Solicitation of Votes with Respect to Prepackaged Plan of Reorganization for JGW Holdco, LLC, J.G. Wentworth, LLC and J.G. Wentworth, Inc. 14 (2009) [hereinafter J.G. Wentworth Disclosure Statement].

181. Id. at 15.

182. Id.

183. E-mail from Earl Nesbitt, Executive Director, NASP, Sept. 11, 2009 to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (on file

of all structured settlements, it is believed that between 5% and 8% of all structured settlements are eventually factored.[184]

Today, a factoring transfer is typically complete three months after a structured settlement recipient first makes contact with the factoring company.[185] Some companies advertise that money can be transferred to recipients within three to six weeks, and even offer cash advances within a few days.[186] Factorers have represented that 88% of structured settlement purchases are "partial purchases,"[187] such that the claimant only sells a portion of his or her future income stream, though J.G. Wentworth has stated that the average factoring customer completes an average of more than two such transactions.[188] According to J.G. Wentworth's[189] Chief Marketing Officer, over 70% of surveyed structured settlement sellers owned their structured settlement for over ten years before factoring.[190]

The factoring market has also fed into securities.[191] In 1997, J.G. Wentworth sold over $140 million of structured settlement securities, paying as much as 7.8% interest per year.[192] Since then, the company has completed nineteen securitizations totaling approximately $2.1 billion.[193] The practice has continued during the 2008 credit crisis,[194] which has been both a boon and a drought to the factoring industry.[195] The reduced availability of credit has driven up business costs, while the downturn has increased consumer demand.[196]

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with author) [hereinafter Nesbitt E-mail, Sept. 11, 2009] (estimating lower numbers for 2009).

184. Id.

185. Bracy Interview, supra note 28.

186. E.g., Seneca One, Getting Started, http://www.senecaone.com/structured-settlement-recipients/getting-started.aspx (last visited Mar. 17, 2009).

187. 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers); Telephone Interview with Andrew Cravenho, CEO, Settlement Quotes LLC (Feb. 19, 2009) [hereinafter Cravenho Interview] (stating that structured settlement purchases are typically for most of the guaranteed portion of a structured settlement).

188. J.G. Wentworth Disclosure Statement, supra note 180, at 15.

189. Bracy Interview, supra note 28 (indicating that J.G. Wentworth and Peachtree are, by far, the largest factoring companies in the industry).

190. The #1 Reason, supra note 18 (citing Ken Murray, J.G. Wentworth's Chief Marketing Officer).

191. Andrada, supra note 36, at 472 (citing O'Connell, supra note 27, at A8).

192. O'Connell, supra note 27, at A8.

193. J.G. Wentworth Disclosure Statement, supra note 180, at 23.

194. See J.G. Wentworth – 2, http://s2kmblog.typepad.com/rethinking_structured_set/2008/12/jg-wentworth-2.html (last visited Feb. 6, 2009).

195. See generally J.G. Wentworth Disclosure Statement, supra note 180.

196. Bracy Interview, supra note 28; Cravenho Interview, supra note 187.

Notice 2010-43

LEGAL PROCESSING DIVISION
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MAY 12 2010

Johnson Regina

From: Gary E. True [GTrue@summerscomptonwells.com]
Sent: Tuesday, May 11, 2010 11:41 AM
To: Notice Comments
Subject: Notice 2010-43 - Guidance Priority list

It would be very helpful if the IRS would provide guidance on handling estates of decedents dying during 2010 and prior to the reenactment of the estate tax, if that occurs.

For example, there is currently no estate tax, but basis step up is allowed to a limited extend. There is currently no guidance on how to record an election or allocation of basis step up.

Thank you,

Gary True
Summers Compton Wells PC
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To ensure compliance with requirements imposed by the Internal Revenue Service, we inform you that any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and may not be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code, or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. In addition, unless expressly stated in writing by me, any U.S. federal tax advice contained in this communication (including any attachments) is not intended or written to be used, and may not be used to (i) support any position taken on any tax or information return, (ii) support a determination that any such position satisfies any return preparation standard, or (iii) avoid any penalties arising from any such position. In addition, you are cautioned to determine (a) whether, in order to avoid certain penalties, applicable law or other IRS guidance requires disclosure of any such position on such return, and (b) if disclosure is warranted, the required form of such disclosure. Please contact me if you desire a tax opinion that may be used for the aforementioned purposes of if you have any questions.

Notice 2010-43

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MAY 12 2010

Johnson Regina

From: Craig Vagt [cvagt@tkw.com]
Sent: Tuesday, May 11, 2010 9:07 PM
To: Notice Comments
Subject: Notice 2010-43
Attachments: image001.jpg

I believe that the service needs to clarify and finalize the regulations related to self employment income and limited liability company members. Limited liability companies are the most common ownership structure for business in the country today. There is still significant confusion on when the income allocated to members is subject to SE tax. The question of whether LLC income is subject to SE tax to a member is an example of unsound tax administration. Not only does the uncertainty give rise to many interpretations, but it creates conflicts between partners in the same partnership.

I realize that efforts have been made in the past to clarify the definition with a resulting firestorm of protest from Congress. Given the financial position of the country, maybe the time is ripe to try again.

It is hard to imagine an issue that is less clear, that affects as many entities and individuals as it does and that lies at the heart of one of the country's biggest cash drains has so little attention.

Craig D Vagt, CPA | Partner
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Notice 2010-43

MAY 19 2010

From: amhavel [mailto:amhavel@vermontel.net]
Sent: Wednesday, May 19, 2010 9:52 AM
To: Notice Comments
Cc: amhavel@vermontel.net
Subject: "Notice 2010-43"

hello,
i would like to propose that there be some kind of small organization exclusion when calculating those contributions that come from a disqualified person. for example, a local person wrote a check to us for $5,000 and sierra club $5,000. to sierra club this is a drop in the bucket and would not render this person disqualified. but to us, he becomes disqualified. his intention was the same in both circumstances. help a non-profit's mission in which he believes. it hurts our calculations but does nothing to sierra club's. this seems unjust. why should our status be jeopardized because we are small? this is particularly problematic in the early years, *when having* to do 8734 calculations. we need all the generosity available, but it shouldn't penalize us just because we have small revenue numbers.

thank you for your consideration of this matter.
anne marie havel

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

MAY 24 2010

May 14, 2010

Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

ATTN: CC: PA: LPD: PR(notice-2010-43) Room 5203

RE: Regulation of Tax Professionals

With specific attention to the INDIVIDUAL PAID TAX PREPARER SMALL BUSINESS

It would be counter productive to charge the same fees for registration, plus a requirement to take expensive Continued Education Courses, to small "schedule C" businesses, preparing less than 75 returns per year, as is charged to CPA's, enrolled agents and lawyers.

Those Professionals charge exorbitant fees to their clients for tax preparation, passing on any increased expense, using their degrees as justification, and their clientele can afford it.

An Individual Paid Tax Preparer's clientele are the low-to-middle-income singles, families, elderly where the cost of a return will range from $50 to $200 and even that is a burden to the tax payer. If we go out of business due to increased expense, it adds to poverty, unemployment, and where does the average citizen go?

SOLUTION:

Keep the Registration Fee very low for PRACTITIONERS WHO DO LESS THAN 75 RETURNS. Provide FREE or LOW-FEE CLASSES using public school facilities throughout the country for us to obtain the 15 hours of continuing professional education required.

Sincerely,

Audrey P Jones

Audrey P. Jones,
4290 Meadow View Dr.
Boynton Beach, Fl. 33436

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

MAY 12 2010

Johnson Regina

From: Don Baaso [donbaaso@comcast.net]
Sent: Tuesday, May 11, 2010 12:32 PM
To: Notice Comments
Subject: NOTICE 2010-43

W-2, 1098 and 1099 series documents should be in standard formats with the boxes in standard locations and font size mandated. W-2 copy B should be in standard page location.

Donald Baaso
donbaaso@comcast.net

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 17 2010

Johnson Regina

From: Jim Segurson [jimseg1@comcast.net]
Sent: Friday, May 14, 2010 7:18 PM
To: Notice Comments
Subject: Notice 2010-43

Over the past few years we have had Stimulus payments and ERP payments that affected the preparation of tax returns. While the payment of these amounts were confirmed with a notice that also indicated that the amount of the payments were required for preparation of their tax returns, these notices were sent at the time of the payment which was far removed from the time that tax notices (W-2's, 1099's, 1098's) are generally received in January. Consequently these ESP/ERP notices were generally unavailable at the time of tax preparation. In each case Phone/web information lines were required to be setup to obtain this information.

We foresee that this coming tax year that we will have taxpayers that will need to pay their first time homebuyers first loan payment. I hope that the IRS will furnish notices to the affected taxpayers during the normal tax notice period.

IRS should request congress to include provisions, in any bill that results in a taxable benefit or tax deductible expense to taxpayers, that will require government agencies to provide notices to the taxpayer during the normal tax notice period of January in the following year.

Jim Segurson

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 28 2010

Johnson Regina

From: John Folkl [johnfolkl@yahoo.com]
Sent: Friday, May 28, 2010 11:23 AM
To: Notice Comments
Subject: NOTICE 2010-43 -- SECTION 199 -- TANGIBLE VS. INTANGIBLE PROPERTY

Pursuant to Notice 2010-43, I respectfully submit the following recommendation for inclusion on the 2010-2011 Guidance Priority List.

BACKGROUND

The section 199 deduction is based on Qualified Production Activities Income (QPAI). QPAI includes income from the manufacture in the U.S. and sale or other qualifying disposition of tangible personal property (TPP). Generally, income from intangible property does not qualify for the sec. 199 deduction. The sec. 199 regulations contain a definition of TPP. However, that definition is seriously deficient and does not provide taxpayers the guidance necessary to distinguish tangible from intangible property.

RECOMMENDED GUIDANCE

The definition of TPP should be modified.

DISCUSSION

Reg. 1.199-3(j)(2)(i) defines TPP. In pertinent part, the regulation states "The term **tangible** personal **property is** any **tangible property** other than land, real property described in paragraph (m)(3) of this section, . . . " (emphasis supplied). The words highlighted in the quoted excerpt isolate the core of the purported definition of TPP and reveal there is no definition at all. The highlighted words say "tangible property is tangible property". **This so-called definition of TPP contained in the existing sec. 199 regulations is not a definition, since it provides no explanation regarding the characteristics that make property tangible.**

The regulations' effort at distinguishing intangible property is equally deficient. Reg. 1.199-3(j)(2)(iii) states "The term tangible personal property does not include property in a form other than in a tangible medium. For example, mass-produced books are tangible personal property, but neither the rights to the underlying manuscript nor an online version of the book is tangible personal property." **As in the case with tangible personal property, the regulations do not attempt to explain what characteristics make property intangible.**

A property's character is determined by its essence. *Webster* defines "essence" as "The indispensable or intrinsic properties that characterize or identify something". The synonym paragraph in *Webster* describes the core meaning of essence as "a basic trait or set of traits that defines the character of something". (*Webster's II New College Dictionary*)

What makes property tangible? Simply put, tangible property is physical. A tangible property's essence is physical. Its indispensable, intrinsic characteristics, its traits that define its character, are physical. A piece of land is composed of soil and rock. Its topography may be flat, hilly, swampy, mountainous, or some combination of these qualities. It has a determinate size and a specific location on the planet. These are physical characteristics, and they make a piece of land what it is. A tangible asset's value is inherent in its physical essence.

Conversely, an intangible property's essence is conceptual, not physical. The intrinsic properties that define its character are conceptual, and may be expressed as ideas, formulas, images, or designs. An intangible property's conceptual essence communicates, informs, or instructs. An intangible property's value is inherent in its conceptual essence.

Language is conceptual. A deed to a tract of land uses language to describe location (described as points of

latitude and longitude) and spatial extent (described as boundaries on the north, south, east and west). Patented industrial know-how uses language to provide relevant information (chemical, mechanical, mathematical, etc.) that explains how something is made or how a task is accomplished. The language (i.e., the concepts) contained in the land deed is **purely descriptive** and serves to identify the particular property. On the other hand, the concepts expressed by the patented know-how are **primarily and essentially instructive** and inform the user, explaining how to perform a task. This distinction between descriptive, identifying concepts and instructive, explanatory, communicative concepts correlates with the difference between tangible and intangible assets. **The land's tangibility derives from its physical essence, not its conceptual description. Know-how's intangibility originates from its conceptual essence -- the concepts ARE the know-how.** A drug formula exemplifies the conceptual essence and instructive nature of know-how. The formula embodies the concepts which provide the instructive information enabling either the owner or a licensee to produce the drug.

The U.S. Supreme Court decision in *Diamond v. Chakrabarty,* 447 U.S. 303 (1980) is particularly helpful in comprehending the distinction between tangibles and intangibles. The case involved patent claims with respect to a human-made micro-organism, developed by the inventor to be used in the clean up of oil spills. The patent claims were of three types. The first was a process claim for the method of producing the bacteria. The second involved an inoculum used to apply or spread the organism. The third patent claim was on the bacteria themselves. The patent examiner allowed patents on the first two claims, but denied a patent on the third claim, the claim on the bacteria themselves.

The issue addressed in *Diamond v. Chakrabarty* concerned whether a living organism was patentable. The Court held the organism itself, a bacterium, was patentable. Perhaps unintentionally, **the case illustrated a key distinction between a patented intangible asset and a patented tangible asset.** As stated above, **a patent was awarded on the process claim for the method of producing the organism. The patented process or method was conceptual, instructive, a patented intangible asset that told the user how to make the organism. The organism itself, a bacterium, was a physical thing and therefore a tangible thing. The patented organism was a patented tangible asset.**

As quoted above, the existing sec. 199 regulations identify mass-produced books as tangible property and the rights to the underlying manuscript or an online version of the book as intangible property. However, the regulations do not explain what makes the mass-produced books tangible and the manuscript or online version of the book intangible. **The intangibility of the manuscript and online version of the book is determined by their conceptual essence, reflecting the fact that their content is strictly conceptual (i.e., information). As stated above, language is conceptual, and both a book manuscript and the online version of the book are comprised totally, exclusively of language the purpose or function of which is to communicate or inform. Further evidencing their intangibility, both a book manuscript and an online version of a book can be transmitted by being encoded on radio waves, carried on those waves as information-bearing signals to devices such as computers and converted back into words to be used (i.e., to be read). Tangible, physical property cannot be transmitted as information-bearing signals.**

In the pre-Internet era, before books were used online, the manuscript still performed the instructive role characteristic of an intangible asset. The manuscript of any novel is basically a bunch of words. That bunch of words requires a very specific arrangement in order to perform the intended task of telling the story. The specific arrangement of words that constitutes the manuscript is essentially formulaic, instructive. The identical bunch of words haphazardly arranged does not tell the story. The manuscript tells the user (the publisher) what to print (how to tell the story). It tells the publisher how to use the purely conceptual, informational content of the manuscript to produce something tangible, a book.

Music, films, and computer software share this intangibility. They all consist of information, some type or form of communication or expression, whether in the form of human language, sound, image, or machine language. Each has a conceptual essence, and as a result, each is intangible.

The patented process in *Diamond v. Chakrabarty* was intangible because it was instructive information that enabled a user to produce the organism. The essence of the process consisted of concepts which explained how to make the bacteria. The concepts **were** the process. The patented bacterium, on the other hand, was tangible because the bacterium was strictly a physical organism. Although a conceptual description of the organism may have been contained in the organism patent, nevertheless, the organism's tangibility derived from its physical essence, not its conceptual description.

SUMMARY

As indicated above, the existing sec. 199 regulations contain seriously deficient definitions of tangible and intangible property. The sec. 199 regulations should be modified to reflect the principles discussed above.

If your require further comments, please advise.

John G. Folkl
643 Cannonbury Dr.
St. Louis, MO 63119
(314) 968-1098
(314) 825-8190 (voicemail)

Notice 2010-43

LEGAL PROCESSING DIVISION MAY 14 2010
PUBLICATION & REGULATIONS
BRANCH

Johnson Regina

From: Glauber Kathleen M [Kathleen.M.Glauber@irs.gov]
Sent: Thursday, May 13, 2010 12:47 PM
To: Notice Comments
Subject: Notice 2010-43

The following suggested changes are for the Publication 590, Individual Retirement Arrangements (IRAs):

- On page 41, Worksheet 1-5 , the statement at the top "Use only if you make contributions to a traditional IRA for 2009 and have to figure the taxable part of your 2009 distributions to determine your modified AGI." does not match the information on page 39 under the heading, "Contributions and Distributions in the same year". Please add the words "that may not be fully deductible" to the statement on the worksheet so it reads: "Use only if you make contributions to a traditional IRA for 2009 that may not be fully deductible and have to figure the taxable part of your 2009 distributions to determine your modified AGI."
- On page 51, Worksheet 1-7, provide an example.
- On page 52, in the paragraph under "Recapture tax changes in distribution method under equal payment exception.", it explains to "Report the recapture tax and interest on line 4 of Form 5329." It does not give an explanation on how to compute the interest.
- On page 62, Explain what to do with a Roth contribution/excess contribution returned after the due date (including extensions).
- There is no explanation in the Publication 590 on how to report the 1099-R received with distribution code "T" in box 7. The information on how to report this distribution is only found in the Form 1040 series instructions. (Form 1040 instructions page 24, Form 1040A instructions page 26)

Thank you

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 12 2010

Johnson Regina

From: Bruce or Kay Lassila [bekjl22@yahoo.com]
Sent: Tuesday, May 11, 2010 8:18 PM
To: Notice Comments
Subject: Notice 2010-43

I would like to see the IRS issue guidance regarding self employment income from an LLC where the member is strictly a passive investor. Because the LLC has trade or business income passing through to its members, it has led to confusion whether that income should be considered self employment income or not.

In the case of a restaurant where the LLC managing partner runs the restaurant operation and draws a salary from the restaurant, should the limited partners who have merely put up capital be subject to self employment income on the ordinary business income that passes through to them?

Thank you.

Kay Lassila

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAY 25 2010

May 12, 2010

Internal Revenue Service
ATTN: CC:PA:LPD:PR (NOTICE 2010-43)
Room 5203
PO Box7604
Ben Franklin Station
Washington, D.C. 20044

Sirs/Ms.,

In response to your notification (IRS) via computer notification requesting ideas to help tax payers, I would like to see a site that provides:

A list of qualified deductions that a retired person may take on their itemized tax forms
A list of qualified deductions that a working person may take on their itemized tax form
In a very clear simple statement so we may complete our tax quickly.
EXAMPLE:
You may list deductions of:

Property tax paid (? All properties you own))
Medical miles driving to see your doctor at (amount) per mile
Charity miles at (amount) per mile (charity means you donate your goods or time free and Receive no pay)
Medical insurance premiums
Other
Other
Other

You must claim as income:
Dividends earned on stocks and investments
Payments from medical insurance paid directly to you
Gains earned from the sale of stock
Interest earned from savings accounts, C.D.'s
Other
Other
Other

I am always afraid I am missing something from either section. I do not do my own taxes, however I list everything for the tax person that does my taxes and he wouldn't know if I missed something, though he is pretty careful about asking if I had one thing or another, but he still wouldn't know if I paid something unless I listed it. This would be very helpful.

Thank you for your attention.

M. J Childs

M.J .Childs
Maj4399@sbcglobal.net

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 17 2010

Johnson Regina

From: MAllenSanDiego@aol.com
Sent: Friday, May 14, 2010 11:42 AM
To: Notice Comments
Subject: Notice 2010-43

There needs to be a "safe harbor" for shareholders of "S" corporations with regard to the minimum amount of compensation those shareholders are paid. This has been a problem for many, many years. As of this writing it's still a very subjective area of the law, and business owners and their advisors continue to struggle with it in an effort to comply with the law as they interpret it.

Mike Allen
San Diego

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAY 19 2010

May 12, 2010

Rose Marie M. Penalber
5119 St. Albert Drive
Fontana, CA 92336

Internal Revenue Service
Attn: CC: PA: LPD: PR
(Notice 2010-43)
Room 5203
PO Box 7604
Ben Franklin Station
Washington, D. C. 20044

Dear Sir/Mdm,

Re: Subject: IR-2010-024 Dated March 2, 2010 "Who have N0T FILED a 2006 Tax Return".

As a tax preparer how could I do my part help the 2007 taxpayers get their refund? Would IRS be able to pass on to me their names and addresses? I may not be able to reach all of them but at least I can try to reach a few who live in SOUTHERN CALIFORNIA. Would this be possible with your help?

Respectfully yours,

Rose Marie M. Penalber

Notice 2010-43

Johnson Regina

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
JUN 14 2010

From: Susan Allair [msallair@cwnet.com]
Sent: Friday, June 11, 2010 1:45 PM
To: Notice Comments
Subject: 2020 - 2011 Guidance Priority List

Guidance is requested regarding application of IRC section 1022 (b)(2) to assets acquired from a decedent dying after December 31, 2009 where such assets were held in decedent's qualified revocable trust at date of death.

Guidance is needed in order for trust beneficiaries to properly compute taxable gains and losses in regards to assets acquired from a decedent dying after December 31, 2009 where such assets were held in decedent's qualified revocable trust at date of death.

Guidance should resolve the discrepancy between subsections (b) and (d) of IRC section 1022 in favor of subsection (d) and provide that "estate" as used in section 1022(b)(2) is not limited to the decedent's estate, but is, instead, intended to encompass all property described under section 1022(d)(1).

Thank you for your consideration.

Notice 2010-43

Johnson Regina

From: Thomas Symonds [symondstes@gmail.com]
Sent: Monday, May 10, 2010 3:33 PM
To: Notice Comments
Subject: Guidance in Notice 2010-43

MAY 11 2010
LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

I think the biggest problem the IRS must tackle in non-filers.

Thomas E Symonds Boise ID

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

JUN 1 2010

Re: Notice 2010-43
Recommendations for 2010-2011 Guidance Priority List

Dear Sir/Madam:

This letter is in response to the invitation for public comment on recommendations for items that should be included in the 2010-2011 Guidance Priority List. I recommend the following guidance projects related to Nonresident Alien (NRA) withholding and Form 1042/1042-S reporting.

- Guidance on how to determine residency status for withholding purposes in the tax year that a foreign national income recipient becomes a resident alien mid-year, but resident status is retroactive to an earlier date during the year

- Practical guidance (including examples) for withholding agents and taxpayers dealing with underwithholding and overwithholding adjustments and timing

Until recently, the IRS's audit and education initiatives regarding NRA withholding and reporting were concentrated in the tax-exempt and financial industries sectors. In the tax-exempt sector, the number of impacted payers and recipients is relatively low as compared to organizations paying U.S. persons. However, the issues regarding the 183-day substantial presence test and tax treaty exemptions can frequently be very complex because many foreign income recipients have multiple visits to the United States in different immigration statuses. In financial industries the number of foreign individual recipients is substantial but most are nonresident aliens because they are outside the United States and their income such as dividends and interest and related treaty issues are simple in comparison to the tax-exempt sector.

With the focus on NRA withholding and 1042/1042-S compliance expanding to include accounts payable functions at for-profit organizations (as well as at tax-exempt organizations), the potential number of organizations and income recipients impacted by the NRA withholding and reporting rules will increase exponentially. Accounts payable administrators not only deal with U.S.-source payments to nonresident aliens and foreign entities outside the United States but also make payments to foreign national individuals in the United States who might become resident aliens in the tax year of payment. In addition, organizations (other than tax-exempt organizations) who routinely employ J-1 exchange visitors and F-1 and J-1 students engaged in post study training are now expected to determine the residency status of their employees and comply with the special payroll rules that apply to those who are nonresident aliens.

1. Tax Residency Determinations

Section 7701(b) of the Internal Revenue Code became effective for tax years beginning with 1985. The rules were written for tax return purposes but applied for all other tax purposes (including withholding and reporting) except estate and gift tax purposes. Under the tax rules, a nonimmigrant's residency start date is retroactive to their first

countable U.S. day in the tax year that they satisfy the 183-day substantial presence test. A nonimmigrant's residency end date is deemed to be December 31 of their tax year of departure from the United States unless they are eligible for and elect to claim an earlier residency end date under the closer connection exception or a tax treaty tiebreaker rule. (The residency end date also applies in situations in which a resident alien becomes a nonresident alien because of a change in residency status such as from H-1B to F-1 student.)

While these rules make sense for tax return purposes when all facts for the tax year are known, they are difficult to apply for withholding and reporting purposes when all facts are not known. (There are no comments in the legislative history of these tax rules about how they should work for withholding purposes.) Administrative personnel who regularly make payments to foreign nationals have many questions about how to apply the retroactive effect of the residency start date, but no official answers.

Payroll administrators typically treat nonresident aliens who will become resident aliens in the tax year as residents from their first countable day in the tax year in order to ensure collection of Social Security and Medicare taxes. Otherwise, employees eligible for the NRA FICA Exception of section 3121(b)(19) would owe a substantial amount of taxes retroactively when they meet the residency change date (typically July 2nd). (Treating these individuals as residents from their first countable day satisfies the IRS audit position.)

Based on discussions on listservs of NRA tax administrators, there is no agreement among administrators about how to treat individuals for NRA withholding purposes who will (or could) become resident aliens in the tax year.

- Should they apply NRA withholding to U.S.-source income payments until the recipient's residency change date (assuming they know from immigration documents when that will occur)?
- Should they treat the individual as a resident from the first countable day in the tax year when they will become a resident alien? (If the organization has the recipient's immigration documents they will know whether the individual is likely to have 183 countable days if the individual is a student or scholar, but not if the individual is a business visitor.)
- If they consistently apply NRA withholding until the recipient is a resident alien, how should they treat an income recipient who is being treated as a resident for FICA purposes?
- Should the rule be different for organizations that know or should know the immigration end date of their payees (such as educational institutions) than for organizations who are unlikely to have the immigration documents of their payees such as financial institutions and accounts payable departments of most organizations? (The latter typically find out about the foreign status of a payee when making the payment.)
- If a recipient is treated as a nonresident alien subject to NRA withholding until the residency change date, should reporting be on a Form 1042-S for the

nonresidency period even though the individual has become a resident alien retroactive to their first countable day?

- If a resident alien is eligible to claim a closer connection exception for an earlier residency end date, can this exception be used for withholding and reporting purposes also? If yes, what form and procedures should the individual submit to the employer or payer use to support the claim?
- If an F, J, or M status student is eligible to claim the closer connection extension (to remain an exempt from counting days individual for more than 5 calendar years), can this exception be used for withholding and reporting purposes also? If yes, what procedures should the individual follow and what documents does the individual need to submit to the employer or payer to support the claim?
- If a resident alien is eligible to claim a later residency start date or earlier residency end date under a tax treaty tiebreaker rule, can this exception be used for withholding and reporting purposes also? If yes, what form and procedures should the individual submit to the employer or payer to support the claim? (At one time, Form 8833 had been designated as a form for withholding purposes.)
- If the recipient has been subject to NRA withholding, should administrators process a refund of overwithheld taxes for recipients who become resident aliens? What if the income is not reportable if the individual is a resident alien (such as taxable scholarships and fellowships)?
- What if a treaty exemption has been allowed and the income recipient becomes a resident alien, abrogating the treaty benefit retroactively? (Under the saving clause of tax treaties, resident aliens are not eligible for benefits under most treaty articles.)
- On a similar note, if a treaty benefit is lost retroactively for prior years because of a retroactive treaty provision, should administrators issue corrected Forms 1042-S (and W-2Cs in the case of employment income for the prior years)?
- Should administrators deny all treaty claims for independent contractor and other payees claiming exemption under treaty articles that are subject to loss under the saving clause who might become resident aliens during the year?

2. NRA Underwithholding and Overwithholding Adjustments

According to the instructions for Form 1042-S (page 14), withheld taxes in box 7 and 9 must be recorded as actually withheld. If the taxes withheld were repaid to a recipient, the amount repaid must be recorded in box 10 but only if the payer is using the amount repaid to reduce a deposit in the following calendar year. Although there are no instructions for Form 1042-S indicating how to record overwithheld tax refunded by March 15 of the following year, IRS Publication 515 states that in the case where reimbursement is made under a setoff (from future amounts owed by the recipient for the tax year) the actual amount of tax withheld is reduced by the repayment.

Underwithholding is frequently discovered at the end of the year. There are no instructions in Publication 515 about how or when to pay underwithheld taxes or how these payments should be deposited or recorded on an individual's Form 1042-S and on the payer's Form 1042 tax return.

IRS Publication 1187, which provides specifications for electronic filing of Forms 1042-S, requires that records be indicated as follows: 0 = correctly withheld, 1 = overwithheld, and 2 = underwithheld.

It would be helpful for NRA withholding tax administrators and taxpayers to have examples of how refunds of overwithholding and payments for underwithholding should be recorded by the payer on the recipient's Form 1042-S and the payer's Form 1042 and by the recipient on their Form 1120F, 1040NR or 1040NR-EZ. Examples should include services income (ECI) as well as FDAP income because they are taxed differently on the recipient's tax return.

- Refunds from the 10 percent allowed to be retained from deposits.
- Refunds using the reimbursement method in which the amount repaid reduces deposits in the subsequent year and is recorded in box 10 of Form 1042-S. (Note that although the actual tax withheld remains in box 7 and 9, there are no instructions for where to record the amount of the repayment on Form 1120F or 1040NR(EZ). For individual tax return purposes, this means that the individual taxpayer actually claims a greater withholding credit than they are entitled to because they are not instructed to net actual tax withheld against any repayments reported in box 10 of Form 1042-S.)
- Refunds using the reimbursement method in which the amount repaid is refunded to the payer as an overpayment on Form 1042 instead of used to reduce subsequent tax year deposits
- Refunds using the setoff method in which case the withheld tax is recorded net of the repayment.
- Payment of underwithheld taxes by the payer by March 15 through a gross-up method with a late deposit.
- Payment of underwithheld taxes by the payer submitted with Form 1042 as the payer's liability for underwithholding, calculated on a grossed-up basis.

Payment of underwithheld taxes by the payer submitted with Form 1042 in satisfaction of the beneficial owner's tax liability and not as additional income of the recipient from whom no tax was withheld inadvertently.

It would be helpful for taxpayers to have:

- Examples of how to complete a Form 1120-F, 1040NR or 1040NR-EZ for effectively connected income on which taxes have been withheld and reported on Form 1042-S 1) without a repayment, 2) with a repayment and net taxes recorded in box 9, and 3) with a repayment and actual taxes withheld recorded in box 9 with a repayment recorded in box 10.

- Examples of how Form 4669 should be completed for payers wishing to reduce their liability for underwithheld NRA withholding by showing evidence

that the recipient submitted a U.S. tax return and paid the tax or made a proper claim for an exemption from tax.

Lastly, it would be helpful to have this information available all in one place in a publication and on the web. This would provide resources for payers who must now determine how to complete the forms properly and would also allow payers to point their vendors to IRS resources which can help them to submit proper tax returns.

Very truly yours,

Paula N. Singer, Esq.
Partner, Vacovec, Mayotte& Singer LLP
Chair, Windstar Technologies, Inc.

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
JUL 1 2010

Johnson Regina

From: Ann Waller [Ann@annwallertax.com]
Sent: Tuesday, June 29, 2010 6:37 PM
To: Notice Comments
Cc: Craven James M
Subject: Notice 2010-43, Guidance priority list public comment

I am an Enrolled Agent in Moss Point, MS. I would like to strongly suggest an item that I feel should be on the priority list for this session. I believe this issue is relevant to many taxpayers, it promotes fair and sound tax administration, it would be more easily understood, and would be infinitely easier to administer that the current status. It definitely would reduce controversy and lessen the burden on both taxpayers and the Service. I personally have two sons, an employee, and numerous clients who are affected by this.

The 2008 First time home buyers received a credit of $7,500 which must be repaid over 15 years, $500 per year. This is grossly unfair to those taxpayers; the 2009 buyers received more credit ($8,000) BUT they do not have to repay it. The inequity of the amounts is not a great concern because we realize the incentive was greater to purchase new homes. And we do realize the burden for the Service because of abuse and fraud in taxpayers applying for credit who did not qualify for it.

However, the true burden will be over the next 15 years for taxpayers, the Service and tax preparers as we attempt to track these repayments. I dare to say it will be impossible for any of us to do this with any degree of certainty. As we preparers change software companies, or as taxpayers change preparers or attempt to file their own returns electronically (which is encouraged), the margin for error will be burdensome to everyone involved, especially to Internal Revenue Service.

I respectfully request that the debt for this First-time Home Buyer tax credit for 2008 recipients be forgiven for the above reasons. I am active in the NATP and NAEA organizations, and everyone I talk with foresees ongoing problems. I hope you will agree this needs resolution.

Thank you for your consideration of this issue. If you wish to contact me, please reply or you may call me at (228) 475-6655.

Sincerely,

Ann Waller EA
4812 Main Street
Moss Point, MS 39563-2700

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
JUL 1 2010

Johnson Regina

From: Ann Waller [Ann@annwallertax.com]
Sent: Tuesday, June 29, 2010 6:37 PM
To: Notice Comments
Cc: Craven James M
Subject: Notice 2010-43, Guidance priority list public comment

I am an Enrolled Agent in Moss Point, MS. I would like to strongly suggest an item that I feel should be on the priority list for this session. I believe this issue is relevant to many taxpayers, it promotes fair and sound tax administration, it would be more easily understood, and would be infinitely easier to administer that the current status. It definitely would reduce controversy and lessen the burden on both taxpayers and the Service. I personally have two sons, an employee, and numerous clients who are affected by this.

The 2008 First time home buyers received a credit of $7,500 which must be repaid over 15 years, $500 per year. This is grossly unfair to those taxpayers; the 2009 buyers received more credit ($8,000) BUT they do not have to repay it. The inequity of the amounts is not a great concern because we realize the incentive was greater to purchase new homes. And we do realize the burden for the Service because of abuse and fraud in taxpayers applying for credit who did not qualify for it.

However, the true burden will be over the next 15 years for taxpayers, the Service and tax preparers as we attempt to track these repayments. I dare to say it will be impossible for any of us to do this with any degree of certainty. As we preparers change software companies, or as taxpayers change preparers or attempt to file their own returns electronically (which is encouraged), the margin for error will be burdensome to everyone involved, especially to Internal Revenue Service.

I respectfully request that the debt for this First-time Home Buyer tax credit for 2008 recipients be forgiven for the above reasons. I am active in the NATP and NAEA organizations, and everyone I talk with foresees ongoing problems. I hope you will agree this needs resolution.

Thank you for your consideration of this issue. If you wish to contact me, please reply or you may call me at (228) 475-6655.

Sincerely,

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Notice 2010-43

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Re: Notice 2010-43
Invitation to Comment on the 2010-2011 Guidance Priorities
Recommendation to Include Changes to the Conformity Election

Gentlemen:

I appreciate the Service's invitation in Notice 2010-43 to provide recommendations for items that should be included on the 2010-2011 Guidance Priority List.

Recommended New Guidance - As discussed in more detail below, I recommend that the Service include an update to the Conformity Election by financial institutions for the deduction of bad debt losses. This recommendation would involve at least:

- Revisions to Regulation Section 1.166-2(d)(3).
- Revisions to Revenue Procedure 92-84.
- A new Revenue Procedure permitting an automatic perfection of technically invalid Elections.

Why New Guidance is Needed - The Conformity Election was adopted as a Final Regulation in Treasury Decision 8396, dated February 24, 1992. At the same time, the Service issued Revenue Procedure 92-18 with the form and content of the Express Determination Letter that a bank must obtain from its supervisory authority to qualify for the Election. The supervisory authority must

determine that the bank maintains and applies the proper loan review and classification standards. The Express Determination Letter was modified in Revenue Procedure 92-84.[1]

Many of the larger banks made the Conformity Election shortly after the adoption of the Final Regulation, or after the publication of Revenue Ruling 2001-59 clarifying the determination of whether a charge-off has been classified as a "loss asset."

However, it is my observation that many smaller community banks, probably the majority, still have not made the Conformity Election, now 18 years after the adoption of the Final Regulation.[2] Most community banks avoided the Election for many years for a number of reasons, none of which continue to apply. Now that community banks are attempting to make the Election in substantial numbers, it is also my observation that many of the Elections that have been made are technically invalid.[3]

The Conformity Election was an outstanding effort by the Service to both clarify and simplify a growing and difficult issue for bank taxpayers during the 1980s.

Recall that the Election came after the widespread credit crisis during the 1980s when banks incurred major losses on agricultural and energy loans, and many banks failed. The banks found themselves] between the federal examiners who were aggressively ordering higher reserves and loan charge-offs, and IRS examiners whose focus was whether the charge-offs were truly loss assets. The Conformity Election was a logical approach to end this stand-off. The Election enables taxpayers to more accurately determine taxable income and conserves the Services' examination resources.

During approximately the same period of time, the banking industry experienced considerable consolidation as banking became less local and more regional and national. The larger regional and national banks were encountering a different issue with their bad debt losses. With their increasing size, and their ever widening branch network, it was becoming increasingly difficult to identify the specific loans charged-off in the branches, or to accumulate the loan information required by IRS examiners to determine that the charge-offs all related to loss assets. The federal banking examiners were already examining the banks' policies and procedures for loan management. In the interest of conserving both the taxpayers' and the Service's resources, the Service initiated the Conformity Election to avoid duplication of efforts.

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[1] Revenue Procedure 92-84 superceded Revenue Procedure 92-18.

[2] I continue to receive numerous requests for a copy of the Express Determination Letter. It is explained to me that when asked for the letter by a bank intending to make the Conformity Election, the federal field examiner in charge has responded that he/she has "no idea" what the bank is requesting, and has never seen one of these letters. While my experience is antidotal, it does illustrate the relative rarity of the Election among the smaller banks for which these particular field examiners have responsibility.

[3] This observation is discussed further below.

The evolution of the banking agencies' examination practices, and banks' experience with a greater volume of Elections, suggests that some updating needs to be done for the Conformity Election to continue to achieve the Service's objectives.

Evaluation Criteria. In Notice 2010-43, the Service listed five criteria for evaluating topics for its guidance priorities.

1. Whether the recommended guidance resolves significant issues relevant to many taxpayers.

   The Conformity Election potentially affects all financial institutions in some way or another. The FDIC financial institution directory states that there were 7,888 insured financial institutions as of June 3, 2010.

2. Whether the recommended guidance promotes sound tax administration.

   My recommendation to revise the rules around the Conformity Election (a) does not introduce any new concept to tax administration, and (b) will encourage an expanded use of this important administrative initiative by the Service.

3. Whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance.

   With one exception (a new Revenue Procedure for automatic perfection of inadvertently invalid Elections), my recommendations are relatively minor revisions to existing guidance that will remove uncertainty that exists with the current guidance. The proposed new Revenue Procedure will not be difficult to draft or understand. While the subjects are quite different, there are several existing Revenue Procedures in the S corporation area which may serve as conceptual models for the proposed Procedure.

4. Whether the Service can administer the recommended guidance on a uniform basis.

   My recommendations will make the existing guidance easier to administer on a uniform basis.

5. Whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

   The purpose of the Conformity Election was to reduce controversy and conserve the resources of both taxpayers and the Service. My recommended revisions will cause more banks to make the Election, making the Election more effective.

Issues to Address

When is the First Express Determination Letter Required? - It has not been easy for banks, and their professional advisers, to determine when the first Express Determination Letter is required. Regulation Section 1.166-2(d)(3)(iii)(C)(1) states in relevant part:

> "The ... Form 3115 must ... contain a declaration that the express determination requirement of paragraph (d)(3)(iii)(D) of this section *is satisfied for the taxable year of the election.*" [italics added]

The standard wording of the Express Determination Letter is in Revenue Procedure 92-84 and reads in relevant part:

> "In connection with the most recent examination of [name of bank], by [name of supervisory authority], as of [examination date], we reviewed the institution's loan review process as it relates to loan charge-offs. Based on our review, *we concluded that the bank, as of that date*, maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs." [italics added]

Note that the Express Determination Letter is as of the examination date, and that the examiners' conclusion is "as of that date." The Express Determination Letter does not cover the period from the previous examination to the current examination. Rather, it is a "snap shot" as of the examination date.

The Regulation requires that the Express Determination Letter requirement be "satisfied for the taxable year of the Election." Accordingly, for the bank to have an Express Determination Letter for the full taxable year for which the Election is made, the first Express Determination Letter would appear to be needed for the last federal examination date *prior to the beginning of the taxable year.* A representative of the Service who is familiar with the Conformity Election has concurred orally with this analysis.

This requirement creates a very difficult logistics problem. I understand that since the Regulation was issued in 1992, the federal banking examiners have changed their examination cycles to 18 months. Accordingly, for a bank using the calendar tax year to make the Conformity Election for 2010, it may have needed to have obtained the Express Determination Letter as early as an examination date in July 2008, and certainly some time in 2009. This timing issue has become a material deterrent to making the Election.[4]

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[4] I continue to hear from CPAs that the timing issue is sometimes complicated by some field examiners' reluctance to provide the Express Determination Letter unless the bank has made the Election, or at least represents that it will make the Election in the current year. This is not a universal issue, but it is one that could be mitigated by my suggestion below that the updated Revenue Procedure 92-84 specifically observe that the Express Determination Letter does not have to be rendered at the completion of the examination.

In addition, many advisers have not appreciated the nuances described above. They have believed that the letter was not needed until a federal examination during the year that the Election was made, resulting in numerous technically invalid Elections.

The examination process is actually a somewhat "mixed" process. On the one hand, the examination is as of a specified date, usually when the field work begins. The form Express Determination Letter includes that date. On the other hand, the examiners take notice of changes and developments in the bank's policies and procedures since the previous examination. Accordingly, the Service does not need for the bank to obtain an Express Determination Letter for examinations before the election year. An Express Determination Letter for an examination during the election year, or even shortly after the election year if necessary, is actually more relevant than an earlier examination before the beginning of the election year to assure the Service that the bank maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs during the taxable year of the Election.

The Service would encourage more community banks to make the Conformity Election if the first Express Determination Letter were required for the first examination date *after* the beginning of the year for which the Election is effective, rather than the first examination *before* the beginning of the year. I recommend that Regulation Section 1.166-2(d)(3)(iii)(D) be revised to read somewhat as follows:

> "(D) Express determination requirement. In connection with its ~~most recent~~ first examination involving the bank's loan review process after the beginning of the tax year for which the election is made, the bank's supervisory authority must have made an express determination (in accordance with any applicable administrative procedure prescribed hereunder) that the bank maintains and applies loan loss classification standards that are consistent with the regulatory standards of that supervisory authority. For purposes of this paragraph (d)(3)(iii)(D), the supervisory authority of a bank is the appropriate Federal banking agency for the bank, as that term is defined in 12 U.S.C. 1813(q), or, in the case of an institution in the Farm Credit System, the Farm Credit Administration."[5]

May the Express Determination Letter be obtained after the examination is completed? It is my observation from conversations with CPAs who advise banks and thrifts throughout the country that there is little consistency among field bank examiners whether they will issue an Express Determination Letter as of a previous examination date if the letter was not requested during the examination. More often, field examiners are not willing to issue a letter after the examination is finished.

The Service's interest is whether the bank examiners were satisfied as of the examination date that the bank maintained and applied loan loss classification standards that were consistent with

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[5] Throughout this letter, proposed new language is in red and language proposed to be removed is in red and overstruck.

regulatory standards regarding loan charge-offs. If the bank examiners were satisfied with the bank's loan loss classification standards, that will be clear to them from their workpapers. If they were not satisfied with the bank's classification standards, that will also be clear in the workpapers and will be mentioned in the examination report. Of course, it would be nice for the Express Determination Letter to be contemporaneous with the examination report, but there is no tax imperative for it to be so.

In practice, whether to make the Conformity Election is discussed by the bank with its professional advisers either in the pre-year end financial review and/or preliminary audit work, or during preparation of the income tax return. I am confident that more community banks would make the Conformity Election if it is made clear that there is no objection to the bank field examiner providing the Express Determination Letter after the examination is finished, based on the examination files.

I recommend that Section 4.01 of Revenue Procedure 92-84 be revised to read as follows:

> "SEC. 4. PROCEDURE. 01 An express determination within the meaning of section 2.03 of this revenue procedure and section 1.166-2(d)(3) of the regulations is a letter that is provided by the bank's supervisory authority as defined in section 1.166-2(d)(3)(iii)(D), either contemporaneously with the examination report or before the next succeeding examination. The letter ~~that~~ is separate and distinct from the examination report, ~~that~~ is signed and dated as of the date rendered by the examiner in charge, and ~~that~~ contains the following statement: ..."

Declaration regarding the Express Determination Letter on the Form 3115. I have quoted above the requirement in Regulation 1.166-2(d)(3)(iii)(C)(1) that the Form 3115 include a declaration that the Express Determination Letter requirement is satisfied for the taxable year of the Election. Unfortunately, the Regulation goes on to state that the declaration is made in the space provided on the form for "Other changes in method of accounting." Subsequent revisions to the Form 3115 have eliminated that space from the form. As a result, it is my observation that banks and their advisers tend to overlook the declaration requirement because there is no place on the current Form 3115 to make it. In addition, the current content of Form 3115 does not alert the preparer to either the possible issue with the declaration or the date for which the Express Determination Letter is required.

The result is a substantial number of Conformity Elections which are technically invalid because they do not include the declaration.

I recommend that the Service delete the "declaration " requirement from the Regulation, and in lieu of the declaration, revise Form 3115 to include a separate schedule for the Conformity Election. The Form 3115 schedule should include a question regarding the first examination date for which the Express Determination Letter was obtained.

Must a copy of the Form 3115 be sent to the IRS National Office? The existing guidance appears to provide that a copy of the Form 3115 is not required to be filed with the National Office. However, because banks have only one opportunity in the entire life of the bank to make an automatic Conformity Election, caution requires that CPAs advise their clients to file a copy of the Form 3115 with the National Office whether or not the bank is actually required to do so.

Section 6.02(3) of Revenue Procedure 2008-52 reads in relevant part:

> "(3) Timely duplicate filing requirement. (a) In general. A taxpayer changing a method of accounting pursuant to this revenue procedure must complete and file an application in duplicate. The original must be attached to the taxpayer's timely filed (including any extension) original federal income tax return for the year of change, and a copy (with signature) of the application must be filed with the national office (see section 6.02(7) of this revenue procedure for the address) no earlier than the first day of the year of change and *no later than when the original is filed with the federal income tax return for the year of change*. ..." [italics added]

The instructions to Form 3115 state in the section captioned "When and Where to File"

> "Automatic change requests. A Form 3115 that is filed under the automatic change request procedures is filed in duplicate. The original must be attached to the filer's timely filed (including extensions) federal income tax return for the year of change. A copy of the Form 3115 must be filed with the IRS National Office (see below) no earlier than the first day of the year of change and no later than when the original is filed with the federal income tax return for the year of change."

On the other hand, the Regulation has no requirement to file a copy of the Form 3115 with the National Office. Regulation 1.166-2(d)(3)(iii)(C)(2) states in relevant part:

> "(2) First election. The first time a bank makes this election, the statement or Form 3115 must be attached to the bank's timely filed return (taking into account extensions of time to file) for the first taxable year covered by the election. The consent of the Commissioner to make a change in method of accounting under this paragraph (d)(3) is granted, pursuant to section 446(e), to any bank that makes the election in accordance with this paragraph (d)(3)(iii)(C), provided the bank has not made a prior election under this paragraph (d)(3))."

The Form 3115 instructions for the Conformity Election also suggest that a copy is not required to be filed with the National Office. The instructions state in relevant part:

> "**6. Bad debt conformity for banks (section 166)** - Banks, other than new banks, to the method that conforms to section 1.166-2(d)(3) for the first time the bank makes this change, or to involuntarily revoke this method. This does not fall under the procedures of Rev. Proc. 2002-9. *Instead, see Regulations section 1.166-2(d)(3).*" [bold and italics in original]

If we substitute Revenue Procedure 2008-52 for Revenue Procedure 2002-9, then the instructions would indicate that the duplicate filing requirement of Revenue Procedure 2008-52 do not apply.

I recommend that the Service clarify this question by revising the Regulation Section 1.166-2(d)(3)(iii)(C) to read somewhat as follows:

> "(C) Procedures. (1) In general. A new bank adopts the method of accounting under this paragraph (d)(3) for any taxable year ending on or after December 31, 1991 (and for all subsequent taxable years) when it adopts its overall method of accounting for bad debts, by attaching a statement to this effect to its income tax return for that year.
>
> (2) Any other bank makes an election for any taxable year ending on or after December 31, 1991 (and for all subsequent taxable years) by filing a completed Form 3115 (Application for Change in Accounting Method) in accordance with the Revenue Procedures then applicable to automatic changes of accounting methods and the then current instructions to Form 3115, except that no Copy of Form 3115 is filed with the IRS National Office. ~~the rules of paragraph (d)(3)(iii)(C)(2) or (3) of this section. The statement or Form 3115 must include the name, address, and taxpayer identification number of the electing bank and contain a declaration that the express determination requirement of paragraph (d)(3)(iii)(D) of this section is satisfied for the taxable year of the election) When a Form 3115 is used, the declaration must be made in the space provided on the form for "Other changes in method of accounting." The words "ELECTION UNDER section 1.166-2(d)(3)" must be typed or legibly printed at the top of the statement or page 1 of the Form 3115.~~

The instructions to Form 3115 could be similarly revised to state that no copy is filed with the IRS National Office.

If the National Office concludes that it does need to receive these Forms 3115, then the requirement to file a copy of the Form can be clarified by deleting the except from the above revision.

One chance to make a valid Election. Regulation 1.166-2 provides only one chance in the entire life of a bank to make the Conformity Election automatically, and without a user fee. Regulation 1.166-2(d)(iii)(C)(3) states:

> "(3) Subsequent elections. The advance consent of the Commissioner is required to make any election under this paragraph (d)(3) after a previous election has been revoked pursuant to paragraph (d)(3)(iv) of this section. This consent must be requested under the procedures, terms, and conditions prescribed under the authority of section 446(e) and section 1.446-1(e) for requesting a change in method of accounting."

There is no five year waiting period to remake the Election similar to other automatic changes.

I have discussed orally with a representative of the Service whether an Election without the Express Determination Letter in hand, or filing Form 3115 without attaching the declaration regarding the Express Determination Letter, will be disregarded. I reasoned that if the attempted Election was invalid on its face, then no election was made and a subsequent Form 3115 was the "first election."

I was told that the invalid Election is treated as an election which has been revoked. Accordingly, any subsequent Election, during the entire life of the bank, must be made with the approval of the National Office and is subject to the user fee.

The "once in a lifetime" rule can also complicate changes of control. If the acquired bank has ever revoked a Conformity Election, or had the Election automatically revoked, then the acquirer may not make an automatic Election for the acquired bank, even if all of its other bank subsidiaries are already subject to Conformity Elections. This kind of inconsistency is not in the interest of the Service.

In the interest of conserving the Service's resources, avoiding controversy, and maximizing the number of Conformity Elections, I recommend that the Service take several actions:

- Issue a Revenue Procedure permitting the perfection of a Conformity Election that was inadvertently invalid when it was made.[6]

- Revise the Regulation to permit a new automatic election after a change of control or after five years, and to disregard elections which are invalid when made and which have not been perfected. A new subparagraph (4) should be added to Regulation Section 1.166-2(d)(3)(iii)(C) that reads somewhat as follows:

> "(4) Special rules. For purposes of this subparagraph (C), an election shall be considered a first election if (a) there has been a change of control of the bank after a previous election was either voluntarily or involuntarily revoked, (b) a previous election was voluntarily or involuntarily revoked at least five taxable years before the year for which the new election is made, or (c) a previous attempted election was invalid when it was made. For this purpose, a change of control occurs when there is a change of ownership as if Section 382 applied."

- Change Regulation Section 1.166-2(d)(3)(iv)(C) to Section 1.166-2(d)(3)(v) and revise it to read somewhat as follows:

> "(~~C~~v) Automatic ~~revocation~~ suspension. ~~(I) In general.~~ A bank's election under this paragraph (d)(3) is ~~revoked~~ automatically suspended if, in connection with any examination involving the bank's loan review process by the bank's supervisory authority

[6] This Revenue Procedure would be similar in purpose to Revenue Procedures 97-48, 2003-43, 2004-35, 2004-48, 2004-49, and 2007-62 for perfecting various defects in S corporation, entity classification, and/or QSub elections.

as defined in paragraph (d)(3)(iii)(D) of this section, the bank does not obtain the express determination required by that paragraph.

"(~~2~~1) ~~Year of revocation~~ Suspension period. If a bank makes the conformity election under ~~the transition rules of paragraph (d)(3)(iii)(E) of~~ this section and does not obtain the express determination in connection with ~~the first~~ any subsequent examination involving the bank's loan review process ~~that is after October 1, 1992~~, the election is ~~revoked~~ suspended as of the beginning of the taxable year which includes the examination date, and such suspension continues until such subsequent examination date with respect to which the express determination is obtained. ~~of the election or, if later, the earliest taxable year for which tax may be assessed. In other cases in which a bank does not obtain an express determination in connection with an examination of its loan review process, the election is revoked as of the beginning of the taxable year that includes the date as of which the supervisory authority conducts the examination even if the examination is completed in the following taxable year.~~

This suspension approach protects the interests of the Service in conforming charge-offs for income tax purposes with charge-offs for regulatory purposes, while also serving the Service's purpose to encourage as many Conformity Elections as possible.

Refusal of the federal bank examiners to issue an Express Determination Letter because charge-offs were too late. During the current credit crisis, I have begun to hear of instances in which the federal bank examiners refused to provide the Express Determination Letter because they were ordering the bank to make additional charge-offs at the conclusion of the examination. The examiners reasoned that if their examination results in additional charge-offs, then the bank must not be maintaining loan loss classification standards that are consistent with regulatory standards; i.e. their charge-offs are too late. The bank examiners' refusal to give the Express Determination Letter automatically revokes the bank's Conformity Election.

The Conformity Election was designed to deal with the change in banking practice from the old practice of waiting for an examination to take most charge-offs to a more pro-active program by the bank to take charge-offs as the loss assets are identified.[7] The Service's concern is not that charge-offs are too late, but rather than they are too early. If additional charge-offs are ordered by the federal bank examiners during the examination, those charge-offs should be covered by the presumption in Regulation 1.1662-2(d)(1)(i).

There is no guidance addressing this problem, except for one statement in Revenue Procedure 92-84 that, "For purposes of the express determination, any immaterial individual deviations from regulatory standards will not preclude a finding that a bank maintains and applies loan loss classification standards that are consistent with regulatory standards."

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[7] The bank examiners now criticize banks who wait for the examination to recognize charge-offs.

The difficulty that this creates for banks that have made the Conformity Election is that IRS examiners do not have a consistent or rational approach to the charge-offs which were made by the bank between examinations. I have been told of examinations during the current credit crisis in which the IRS field examiner has at least initially proposed that all of the interim charge-offs be disallowed because (i) they are not covered by a valid Conformity Election, and (ii) they were neither ordered by the bank examiners nor reviewed and approved by the bank examiners during the examination.

I recommend that Revenue Procedure 92-84 be updated to include a new alternative Express Determination Letter that reads somewhat as follows:

> "In connection with the most recent examination of [name of bank], by [name of supervisory authority], as of [examination date], we reviewed the institution's loan review process as it relates to loan charge-offs. Based on our review, and except for certain additional charge-offs which we conclude that the bank should have made before or as of the examination date, we concluded that the bank, as of that date, maintained and applied loan loss classification standards that were consistent with regulatory standards regarding loan charge-offs.
>
> This statement is made on the basis of a review that was conducted in accordance with our normal examination procedures and criteria, including sampling of loans in accordance with those procedures and criteria. It does not in any way limit or preclude any formal or informal supervisory action (including enforcement actions) by this supervisory authority relating to the institution's loan review process or the level at which it maintains its allowance for loan and lease losses."

Charge-offs Required by the Bank Examiners to be Reflected in Periods Prior to the Examination Date - During the current credit crisis, the federal and state banking examiners are requiring banks to record charge-offs of loss assets in periods before the examination date, and to amend their Consolidated Reports of Condition and Income, or the equivalent filing by thrifts or other regulated corporations [popularly referred to as the Call Report].

In this situation, the Regulation clearly implies, but does not specifically direct, that the losses be deducted in the tax year(s) which include(s) the period(s) that the bank examiners require the losses to be reflected in the Call Reports. Regulation 1.166-2(d) reads in relevant part with respect to loans generally:

> "(d) Banks and other regulated corporations. (1) If a bank or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, charges off a debt in whole or in part, either (i) in obedience to the specific orders of such authorities, or (ii) in accordance with established policies of such authorities, and, upon their first audit of the bank or other corporation subsequent to the charge-off, such authorities confirm in writing that the charge-off would have been subject to such specific orders if the audit had been made on the date of the charge-off, then the debt

shall, to the extent charged-off during the taxable year, be conclusively presumed to have become worthless, or worthless only in part, as the case may be, during such taxable year. *But no such debt shall be so conclusively presumed to be worthless, or worthless only in part, as the case may be, if the amount so charged-off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which the charge-off takes place.* [italics added; see discussion below]

"(2) Evidence of worthlessness in later taxable year. If such a bank or other corporation does not claim a deduction for such a totally or partially worthless debt in its return for the taxable year in which the charge-off takes place, but claims the deduction for a later taxable year, then the charge-off in the prior taxable year shall be deemed to have been involuntary and the deduction under section 166 shall be allowed for the taxable year for which claimed, provided that the taxpayer produces sufficient evidence to show that (i) the debt became wholly worthless in the later taxable year, or became recoverable only in part subsequent to the taxable year of the involuntary charge-off, as the case may be; and, (ii) To the extent that the deduction claimed in the later taxable year for a debt partially worthless was not involuntarily charged-off in prior taxable years, it was charged-off in the later taxable year."

If the charge-off is not subject to the Conformity Election, the conservative tax treatment is to deduct the losses in the taxable year in which the bank is required to reflect the charge-offs in the Call Reports. First, that is responsive to the conclusive presumption language because the examiners will have specifically directed the bank regarding the Call Report in which to reflect the charge-off. Second, if the loss is not deducted in that year, subparagraph (2) places a special burden on the bank to produce sufficient evidence that the loan became partly or wholly worthless in the later year. This is a tall bar indeed given that the examiners have specifically chosen the Call Reports in which the bank is required to reflect the charge-offs.

The last sentence of subparagraph (d)(1) [in italics above] creates a real conundrum for the unfortunate bank which is examined after the tax return for the previous year is filed and the bank examiners require that certain losses be recorded in the prior year and that the Call Reports be amended. I am being told of some IRS field examiners who at least initially proposed that such losses were never deductible; (i) they could not be deducted in the prior year when recorded because they were not deducted in the original return, (ii) they could not be deducted in the current year because there was no charge-off in the current year and the bank could not show in the face of the examiners' report that they actually became worthless in the current year, and (iii) could not be deducted in a later year for the same reason. Carried to its logical conclusion, the bank would only be able to deduct the loss when the loan was finally "disposed of" through a settlement with the borrower or a foreclosure. This is not appropriate, and that sentence is not needed in light of current regulatory practice.

Finally, the reference in the Regulation to the examiners having reviewed charge-offs made by the bank between examinations is obsolete. When the Regulation was adopted, the bank examiners

reviewed all of the charge-offs taken by the bank since the previous examination. They stopped doing that many years ago.

If the bank has made the Conformity Election, Regulation Section 1.166-2(d)(3)(ii)(A)(ii)applies. It states in relevant part:

> "(ii) Conclusive presumption. (A) In general. If a bank satisfies the express determination requirement of paragraph (d)(3)(iii)(D) of this section and elects to use the method of accounting under this paragraph (d)(3), (1) Debts charged-off, in whole or in part, for regulatory purposes during a taxable year are conclusively presumed to have become worthless, or worthless only in part, as the case may be, during that year, but only if the charge-off results from a specific order of the bank's supervisory authority or corresponds to the bank's classification of the debt, in whole or in part, as a loss asset, as described in paragraph (d)(3)(ii)(C) of this section ... ."

The result for banks with the Conformity Election appears from this quote to be consistent with the result for banks which have not made the Election. Banks that have made the Conformity Election do not appear to have the same timing issue for examinations after the return is filed, but I am frequently asked about the application of Regulation Section 1.166-2(d)(3)(ii)(B), which states:

> "(B) Charge-off should have been made in earlier year. The conclusive presumption that a debt is worthless in the year that it is charged-off for regulatory purposes applies even if the bank's supervisory authority determines in a subsequent year that the charge-off should have been made in an earlier year. A pattern of charge-offs in the wrong year, however, may result in revocation of the bank's election by the Commissioner pursuant to paragraph (d)(3)(iv)(D) of this section."

This paragraph is difficult to interpret. If the federal or state examiners order the charge-off to be reflected in a Call Report for a year prior to the examination date, then it is "charged-off for regulatory purposes" in that earlier year. There is no charge-off in the year that includes the examination date to which the tax deduction may conform. However, what then is the meaning of the next to last sentence. I believe that it must cover those instances in which (i) the bank makes the charge-off and is not challenged by the bank examiners in that year, and (ii) the bank examiners later conclude during a subsequent examination that the loss should have been recorded in an earlier period, but (iii) the Call Reports are not amended. In that case, the conclusive presumption will apply and hold the year charged-off to be the correct year.

I believe that the interest of the Service in uniform application of the Regulation by taxpayer supports clarifying the Regulation to reflect current bank regulatory practices. I recommend that the Service clarify that losses are to be deducted in the years that they are reflected in the Call Reports or equivalent filings. Regulation Section 1.166-2(d)(1) should read somewhat as follows:

"(d) Banks and other regulated corporations. (1) If a bank or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards, charges off a debt in whole or in part, ~~either (i)~~ in obedience to the specific orders of such authorities, ~~or (ii) in accordance with established policies of such authorities, and, upon their first audit of the bank or other corporation subsequent to the charge-off, such authorities confirm in writing that the charge-off would have been subject to such specific orders if the audit had been made on the date of the charge-off,~~ then the debt shall, to the extent charged-off during the taxable year, be conclusively presumed to have become worthless, or worthless only in part, as the case may be, during ~~such~~ the taxable year in which the examiners require the charge-off to be reflected in the bank's Consolidated Report of Condition and Income, or equivalent filing, as amended. ~~But no such debt shall be so conclusively presumed to be worthless, or worthless only in part, as the case may be, if the amount so charged off is not claimed as a deduction by the taxpayer at the time of filing the return for the taxable year in which the charge-off takes place.~~

I further recommend that Section 1.166-2(d)(3)(B) be revised to read somewhat as follows:

"(3) Conformity election. ... (B) Charge-off should have been made in earlier year. The conclusive presumption that a debt is worthless in the year that it is reflected in the Consolidated Report of Condition and Income (or the equivalent filing), as amended, ~~charged off for regulatory purposes~~ applies even if the bank's supervisory authority determines in a subsequent year that the charge-off should have been made in an ~~earlier~~ different year, providing that either (a) the relevant Consolidated Reports of Condition and Income (or equivalent filings) are not amended, or (b) the statute of limitations is closed on the correct year as ultimately determined by the supervisory authority. A pattern of charge-offs in the wrong year, however, may result in revocation of the bank's election by the Commissioner pursuant to paragraph (d)(3)(iv)(D) of this section."

Tax Return Questions - Certain questions on Forms 1120 and 1120-S will greatly assist an IRS examining agent to efficiently prepare for an examination, and will also assist taxpayers' compliance by focusing their attention on key compliance issues. For example, I am frequently asked what to do if a bank which has made the Conformity Election simply forgets to request the Express Determination Letter during an examination. This is not as unusual as one might expect. Regulatory safety and soundness examinations are relatively intense, the bank employees focus on the facts relating to loans, and the bank's tax advisers are usually not involved. It is not uncommon for the bank's tax advisers to find out about the examination after it is finished, sometimes months after it is finished, especially if the examination went well. A question in the return regarding the Express Determination Letter will not permit that oversight to become stale. If my other recommendation regarding the issuance of Letters after the examination is completed is also adopted, many Conformity Elections would be saved.

I recommend that the Service consider adding four questions to the Forms 1120 and 1120-S as follows:

Is the taxpayer a regulated financial institution subject to the provisions of Regulation 1.166-2(d)?

(a) If the asnwer to __ is yes, has the taxpayer made the conformity election pursuant to Regulation 1.166-2(d)(3)?

(b) If the answer to (a) is yest:

(i) Taxable year for which the Conformity Election was first effective? _____

(ii) Date of the most recent federal examination involving the classification of loans for which an express determination was obtained? _____

Thank you for this opportunity to recommend a guidance topic. Please feel free to contact me to discuss my recommendation further or with any questions which you might have.

Very truly yours,

John E. Cederberg

GROOM

Notice 2010-43

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JUN 14 2010
LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

June 11, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Recommendations for 2010-2011 Guidance Priority List

Dear Sirs and Madams:

Pursuant to Notice 2010-43, we recommend that the Internal Revenue Service (IRS) include, on the 2010-2011 Guidance Priority List, a guidance project that would provide permanent relief for tax-exempt retirement plans – and the persons responsible for their investment affairs – from (1) any requirements to file a Report of Foreign Bank and Financial Accounts (commonly referred to as "FBAR"), and (2) any requirement for these company officials to provide information about pension plan investments on their individual tax returns.

This guidance project should be included in the 2010-2011 Guidance Priority List – and guidance should be issued as soon as possible under the new plan – for the following reasons, reflecting the considerations listed in Notice 2010-43.[1]

1. Guidance regarding certain relief from FBAR filing involves significant issues that are relevant to the many taxpayers that sponsor tax-qualified retirement plans and the persons responsible for their investment affairs. The specter of thousands of retirement plans confronting the costly and burdensome FBAR requirements was first raised one year ago – in response to informal comments of officials of the IRS concerning FBAR compliance by offshore hedge funds commonly used by tax-exempt retirement plans – and remains unresolved to this day.

[1] We understand that FBAR is not solely within the jurisdiction of Treasury and the Service, but note that representatives of the International Tax and SB/SE branches share some responsibility for FBAR with the Office of Financial Crimes Enforcement Network.

2. Relief from FBAR filing would not impede sound tax administration for the following reasons:

- the objectives of FBAR reporting are already achieved by the current regulatory requirements for retirement plans since federal law imposes detailed financial reporting requirements, and rigorous fiduciary standards, on retirement plans and plan officials, and
- such entities pose virtually no risk of tax evasion, money laundering or terrorist activities – the concerns underlying the FBAR scheme.

3. The relief can be drafted in a manner that is easily understood by tax-exempt retirement plans and the persons responsible for their investment affairs. Rather, it is the FBAR reporting that is confusing and burdensome to plans and plan officials. In addition, we are concerned that the FBAR reporting requirements will make individuals less willing to participate in the investment affairs of these plans.

4. The proposed relief would be easy for the IRS to administer, since it would only apply to tax-exempt retirement plans and the persons responsible for their investment affairs.

5. The relief from FBAR reporting that we request in this letter would greatly lessen the burdens on both the IRS and on tax-exempt retirement plans and the persons responsible for their investments.

We appreciate your considering this request. A letter containing our most recent comments and recommendations in this area are enclosed. We are available to discuss this request with you at any time.

Sincerely,

William F. Sweetnam, Jr.

Louis T. Mazawey

Enclosure

Notice 2010-43

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JUN 14 2010

LEGAL PROCESSING DIVISION
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By Electronic Delivery

June 11, 2010

The Honorable Michael Mundaca
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

RE: Guidance Priority List Recommendations

Dear Mr. Mundaca and Mr. Wilkins:

The Investment Company Institute[1] recommends the following issues affecting regulated investment companies ("RICs") and their shareholders for inclusion on the 2010-2011 Guidance Priority List.[2] As requested in Notice 2010-43, these recommendations have been listed in order of priority. The Institute notes, however, that all of the issues described below are important to the industry and their shareholders; most of these items have been included in prior requests for guidance from the Internal Revenue Service ("IRS") and the Treasury Department, including prior suggestions for the Guidance Priority List.

I. 2009-2010 Guidance Priority List Items

The Institute requests that the IRS and Treasury Department issue guidance as soon as possible on the following items currently on the 2009-2010 Guidance Priority List.

A. Final Regulations on Cost Basis Reporting

First, the Institute urges the IRS and Treasury Department to issue final regulations, implementing the mandatory cost basis reporting requirements enacted in 2008, that adopt our recommendations. As discussed in our comment letters,[3] the proposed regulations raise many issues

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.97 trillion and serve almost 90 million shareholders.

[2] A separate submission describes our Guidance Priority List recommendations for retirement security issues.

[3] *See* Institute letters to William J. Wilkins dated February 8, 2010, and May 25, 2010.

that must be resolved before mutual funds and brokers can begin the necessary programming and systems changes. We believe that our proposed solutions would make implementation of this new reporting regime more workable, easing the burdens to brokers, shareholders, and the government while preserving the goals of the statute. As the IRS and Treasury Department are aware, guidance is needed as soon as possible so the industry can comply fully with the January 1, 2012 effective date.

B. Distressed Debt

Second, the Institute requests guidance addressing the accrual of interest on distressed debt. Investors have long faced uncertainty regarding how the existing original issue discount and market discount rules should apply to severely distressed, and speculative, debt. In other cases, application of these rules creates what many believe to be inappropriate results.[4] These issues have been exacerbated by recent market events.[5]

C. Notional Principal Contracts

Third, the Institute remains very interested in guidance providing simplicity and certainty regarding the taxation of notional principal contracts. In our letter on the regulations proposed in 2004,[6] we expressed reservations about the proposed regulations' complexity and recommended significant modifications. We recommended that marks under the elective mark-to-market method, as well as value payments under the noncontingent swap method, be treated as resulting in capital gain or loss. We also suggested that credit default swaps and certain short-term swaps be excluded from the modified noncontingent swap method and the mark-to-market election. We requested additional guidance on determining whether a payment is "significant." We also commented on several technical issues. Finally, we suggested that the guidance should be made entirely prospective upon promulgation of final regulations.

D. Prepaid Forward Contracts

Finally, we urge guidance on prepaid forward contracts.[7] Specifically, the Institute strongly supports prompt and comprehensive guidance regarding the tax treatment of exchange-traded notes ("ETNs"). While ETNs can provide important investment opportunities, they also take advantage of gaps in the tax law to provide investors with tax deferral (of up to 30 years) and character conversion

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[4] *See*, e.g., Letter of May 15, 1991, from Jere D. McGaffey to Fred T. Goldberg, Jr. (transmitting comments prepared by members of the ABA's Section of Taxation on the application of market discount rules to speculative bonds).

[5] *See*, e.g., Institute letter to Eric Solomon and Donald Korb, dated July 28, 2008.

[6] *See* Institute letter to Greg F. Jenner and Donald L. Korb, dated July 21, 2004.

[7] *See* Institute letter to Eric Solomon and Donald L. Korb, dated May 13, 2008. See also, Testimony of William M. Paul on behalf of the Institute, presented on March 5, 2008 before the House Ways and Means Subcommittee on Select Revenue Measures. http://waysandmeans.house.gov/hearings.asp?formmode=view&id=6824.

that is inappropriate. This treatment is far more favorable than the treatment obtained by investors in comparable financial instruments and provides a tax incentive to take on issuer credit risk (rather than invest in products that do not entail this risk). In the absence of legislation, regulations should be issued under Treasury's existing authority under section 1260 and should provide a mark-to-market election. If a comprehensive regulatory approach is not developed under section 1260, guidance should be issued under section 446 to address any ETNs that remain outside the scope of the section 1260 constructive ownership solution.

II. Items Deleted from the 2009-2010 Guidance Priority List

A number of items affecting RICs and their shareholders were deleted from the 2009-2010 Priority Guidance List without guidance being issued. Legislation introduced in the House of Representatives in 2009 (H.R. 4337, the Regulated Investment Company Modernization Act of 2009) effectively would resolve two concerns that would have been addressed by items on prior Guidance Priority Lists:

- the application of section 1(h) to RIC capital gain dividends[8] and similar bifurcation-related issues arising under section 871(k)(2), which permits flow-through of short-term capital gain dividends; and

- minor errors made by RICs, such as mathematical, computer and processing errors that may create preferential dividends.[9]

We urge the Treasury Department's support for this important legislation[10] and the issuance of any post-enactment guidance that might be necessary. Should additional issues arise relating to capital gain dividends or minor errors, we will request guidance addressing them.

The ICI also urges the IRS and Treasury to address issues regarding section 529 qualified tuition programs ("section 529 plans"). A project to address these issues, which was included on prior Guidance Priority Lists, similarly was deleted from the 2009-2010 list without guidance being issued. Guidance regarding section 529 plans remains necessary to implement fully the Advance Notice of Proposed Rulemaking ("Advance Notice") regarding section 529 plans that the IRS released in 2008. We are pleased that the Advance Notice reflects several comments previously submitted jointly by the

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[8] *See* e.g., Institute letter to Alice Bennett, dated May 24, 2006.

[9] *See* Institute letter to Eric Solomon and Donald L. Korb, dated September 12, 2008.

[10] The RIC Modernization Act legislation also would address several other issues that have been included in prior ICI letters requesting items for the Guidance Priority List. These items include: (1) treating all redemptions of mutual fund shares as not being essentially equivalent to a dividend; (2) addressing certain "flow-through" issues for funds of funds; and (3) providing automatic extensions to file IRS Forms 1120-RIC.

Institute and the Securities Industry and Financial Markets Association ("SIFMA").[11] It remains important, for those saving for education through section 529 plans, that the tax treatment of investments in such plans be clear. We urge the IRS to continue its work on this guidance project to address outstanding issues.[12]

III. Other Issues Directly Affecting RICs and Their Shareholders[13]

A. The Application of General Corporate Tax Rules to RICs

The Institute requests that the IRS and Treasury address issues arising from the application of the general corporate tax rules to RICs. These rules can be unnecessarily difficult to apply and can result in unintended consequences.

1. Business Continuity Requirement for Tax-Free Mergers

First, the Institute requests guidance clarifying the application of the "business continuity" requirement to RICs under section 368 and Treas. Reg. § 1.368-1(d)(2).[14] This clarification is necessary because it is difficult to discern the intended scope of the business continuity test as applied to RIC reorganizations. As a result, many RICs engaging in merger transactions are compelled to rely on the "asset continuity" test;[15] this test, to the detriment of the RIC's shareholders, can place artificial limits on the ability of a portfolio manager to dispose of portfolio securities acquired from a target RIC and imposes significant compliance burdens on funds. This issue has become increasingly important given recent financial conditions, under which more and more RICs are being merged. The Institute requested guidance on this issue in 2004, at which point the IRS informed us that they wished to gather more information on RIC mergers through the private letter ruling process. The Institute hopes that the IRS and Treasury now have sufficient information to open a project on this issue and requests that they do so.

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[11] *See* Institute and SIFMA letter to Michael Desmond, dated June 12, 2007.

[12] *See* Institute letter to Richard Hurst, Mary Berman and Monice Rosenbaum, dated May 12, 2008, for comments regarding the Advance Notice.

[13] At this time, we are not requesting a further extension of Notice 2008-55 (relating to auction rate preferred stock). Should the market conditions persist that necessitated the extension of Notice 2008-55 (provided by Notice 2010-3), we will make a separate request.

[14] *See* Institute letter to William D. Alexander and Lon B. Smith, dated January 15, 2003. *See also* Institute letter to William D. Alexander, dated April 30, 2004.

[15] *See* Treas. Reg. § 1.368-1(d)(3).

2. Ownership Tracking Requirements

Second, the Institute asks that a project be opened to amend the regulations under sections 382 and 383 with respect to ownership tracking requirements that apply to participant-directed retirement accounts holding RIC shares and to variable insurance products. Specifically, the regulations should permit a RIC to look through participant-directed retirement accounts and variable insurance product account owners and treat each participant/investor who holds less than five percent of the RIC's shares as part of the RIC's direct public group. The concerns against which sections 382 and 383 are directed are not implicated when a RIC's new shareholders are retirement accounts or variable insurance product accounts that cannot benefit from such tax attributes.

This change effectively would prevent a large collection of small investors making independent investment decisions from being treated as a single entity for ownership change purposes. Absent this change, a retirement plan administrator's decision as to what RICs to offer in a plan could significantly affect whether other shareholders in the RIC can benefit from the RIC's capital losses even though the retirement plan administrator is neither a beneficial owner of RIC shares nor responsible for allocating investment assets among RICs. Likewise, absent this change, an ownership change could occur if another company buys the insurance company holding the variable insurance product shares.

B. RIC Portfolio Investments

The Institute requests guidance on several issues arising from RICs' portfolio investments.

1. PFICs

First, we ask the IRS and Treasury to issue additional guidance regarding passive foreign investment companies ("PFICs"). The preamble to the final PFIC mark-to-market regulations (TD 9123) published on April 29, 2004, notes in three places that comments received relating to the impact of the PFIC rules on RICs were beyond the scope of that regulations project.[16] We request that a regulations project be opened to address these and other PFIC-related issues faced by the industry.

Specifically, the Institute requests guidance providing (i) that gains from dispositions of former PFIC stock are capital while losses are ordinary to the extent of prior unreversed inclusions; (ii) RICs with automatic consent to terminate a section 1296 election during a non-PFIC year; (iii) that RICs may recognize any change in PFIC status of a foreign corporation for the RIC's taxable year within which the taxable year of the foreign corporation ends; (iv) that the consequences to RICs of applying former Prop. Treas. Reg. § 1.1291-8 will be respected, where relevant, for purposes of section 1296; and (v) that RICs may determine qualified electing fund ("QEF") inclusions using audited financial statements that were prepared using U.S. Generally Accepted Accounting Principles

[16] *See* Institute letter, dated November 22, 2002, and Institute letter to Dale S. Collinson, dated April 24, 2003.

or International Financial Reporting standards, and that all QEF inclusions subject to this election will be treated as ordinary, but retain the capital character of disposition gains and losses.

2. RIC Investments in Partnerships with Different Taxable Year-Ends

Second, we request guidance regarding RIC investments in a partnership in which the RICs and the partnership have different tax years; this guidance should allow RICs to take partnership items into income at the end of each month, rather than at year-end. In general, partners must take partnership items into account at the end of the partnership's tax year. If a RIC invests in a partnership with a different tax year, however, this can cause mismatches between the RIC's distributions and the amount of earnings and profits associated with the partnership's income.

3. Taxable Mortgage Pools

Third, we request regulatory guidance to clarify issues relating to excess inclusion income of a REIT that is a taxable mortgage pool ("TMP") or that has a qualified REIT subsidiary that is a TMP. While Notice 2006-97[17] addressed a few issues, and responded to some of the Institute's concerns with the lack of guidance in this area,[18] many critically important issues remain unresolved. At a minimum, and as requested by the Institute in 2006, guidance should be issued stating that Notice 2006-97 will not be applied until some reasonable period after a practical reporting regime is implemented and the many uncertainties arising from the Notice are resolved.[19]

C. Information Reporting

The Institute also asks the IRS and Treasury Department to issue guidance on several important reporting issues affecting RICs and their shareholders.

1. Uncertain Tax Positions

The Institute urges the IRS to exempt from Schedule UTP reporting those tax positions for which a FIN 48 liability is not recorded because of administrative practice.

2. TIN Masking

Second, the Institute asks the IRS and Treasury Department to make permanent its pilot program permitting information return filers to "mask" (or obscure) the full Social Security number on Forms 1099 and 5498 mailed to investors, with the changes suggested by the Institute.[20] Masking

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[17] 2006-2 C.B. 904.

[18] *See* Institute letter to Eric Solomon and Donald L. Korb, dated May 12, 2006.

[19] *See* Institute letter to Lon B. Smith, dated December 29, 2006.

[20] *See* Institute letter regarding Notice 2009-93, dated April 30, 2010.

or obscuring the full taxpayer identification number is the most effective way to combat identity theft, and many RICs already do so on non-tax documents sent to shareholders. We believe the pilot program is an important step towards minimizing situations in which taxpayers' personal information may be misappropriated from tax forms and, therefore, should be continued.

IV. Foreign Bank and Financial Account Reporting

Finally, we urge the IRS to make permanent its recent guidance regarding Form TD F 90-22.1, the Foreign Bank and Financial Accounts Report ("FBAR"). Specifically, Notice 2010-23 provides that a taxpayer with signature authority over, but no financial interest in, a foreign financial account, and who has no other reportable foreign financial accounts, should check the "no" box in response to FBAR-related questions on federal tax forms for 2009 and earlier years that ask about the existence of a financial interest in, or signature authority over, a foreign financial account. Requiring taxpayers with no financial interest in a foreign financial account to report such information is of no value to the IRS. Therefore, this guidance should be made permanent.

* * *

We will contact your offices shortly to request a meeting to discuss further these issues and their importance to the industry. In the meantime, if we can provide you with any additional information regarding these issues, please do not hesitate to contact me at (202) 326-5832 or lawson@ici.org.

Sincerely,

Keith Lawson
Senior Counsel – Tax Law

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Notice 2010-43

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June 11, 2010

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The Honorable William J. Wilkins
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RE: Guidance Priority List Recommendations on Retirement Security Issues

Dear Mr. Mundaca and Mr. Wilkins:

The Investment Company Institute[1] is pleased to submit recommendations regarding retirement security issues for projects to be included on the 2010-2011 Guidance Priority List. A separate ICI submission describes our recommendations regarding regulated investment companies.

I. Items from 2009-2010 Guidance Priority List

First, we request guidance, possibly in the form of a revenue ruling, regarding how to accomplish an effective 403(b) plan termination.[2] In particular, there is significant confusion surrounding termination of 403(b) plans funded through individual custodial accounts. Effective plan termination depends on distribution of all accumulated benefits within a reasonable period of time. Individual custodial accounts, however, typically do not provide for distribution without the consent of the participant. Therefore, any participant who fails to request a cash distribution or rollover of his or her 403(b) account could jeopardize the effectiveness of the termination.

To resolve this issue, we recommend that guidance provide for at least two possible alternatives as valid means of plan termination: (1) taxation of any remaining balances in individual accounts after a

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.97 trillion and serve almost 90 million shareholders.

[2] *See* ICI letter to W. Thomas Reeder, dated March 17, 2009; and ICI letter to W. Thomas Reeder, dated Nov. 12, 2008.

specified period (e.g., one year) and (2) automatic rollover to an IRA after a specified period, to the extent permitted by the custodial agreement and plan. Guidance in this regard will facilitate any necessary amendments to custodial agreements to permit automatic rollovers to IRAs in connection with plan termination and would allow custodians to rely on an employer's direction that a plan is being terminated. The Institute has strongly urged that this guidance be published as soon as possible, given that some employers have begun the process of terminating their 403(b) plans pursuant to the 2007 final regulations issued under section 403(b).[3]

Second, we request finalization of the draft prototype program for 403(b) plans described in Announcement 2009-34 and sample plan language released concurrent with the Announcement. It is important to establish an opinion letter program for 403(b) prototype plans so that employers and plan service providers can have greater certainty in operating under the new 403(b) regulations and guidance. As we have recommended previously,[4] certain changes should be made to the draft Revenue Procedure and sample plan language, including allowing the terms of individual agreements to govern as appropriate and, for other purposes, allowing individual agreements to incorporate plan provisions by reference. We also urge the Service to allow prototype 403(b) plans to use vesting schedules.

II. New 2010-2011 Guidance Priority List Items

The Institute requests that the Service add the following retirement security matters to the 2010-2011 Guidance Priority List. First, we request guidance on partial rollovers of plan distributions containing after-tax employee contributions. A sentence included in the updated model 402(f) notice published in September 2009 has created confusion regarding the allocation of after-tax basis and pre-tax amounts in a distribution that is partially rolled over to a plan or IRA. Under the prevailing view of practitioners and service providers, Code section 402(c)(2) provides that in a distribution containing after-tax amounts that is partially rolled over (directly or indirectly), pre-tax amounts are considered rolled-over first. In the view espoused in the model 402(f) notice, however, pre-tax amounts would be considered rolled-over first only in an indirect rollover; in a direct rollover, the amount rolled over would consist of a pro-rata share of basis and pre-tax amounts. We strongly urge the Service to issue guidance and a revised 402(f) notice confirming that the former view – pre-tax first – is correct. There is no statutory authority that compels the interpretation espoused in the 402(f) notice, and in the interests of sound tax policy, indirect rollovers should not be favored over direct rollovers.[5] At a minimum, if the Service is unwilling to reverse the pro-rata interpretation implied by the 402(f) notice, we feel it is imperative to enforce the pro-rata rule for partial rollovers prospectively only. Due to the

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[3] 72 Fed. Reg. 41128 (July 26, 2007).

[4] *See* ICI letter to Internal Revenue Service re: Announcement 2009-34, dated June 1, 2009.

[5] A participant desiring to roll over the taxable part of a distribution to another plan or IRA, while receiving the non-taxable portion in cash or rolling it over into a separate vehicle, could do so via an indirect 60-day rollover, but ostensibly could not accomplish the same result via direct rollover under the Service's recent interpretation.

multitude of past transactions thought to be properly executed under 402(c)(2), anything other than prospective enforcement would cause considerable disruption and challenges.

Second, we request that the Service finalize the proposed regulations implementing section 1102 of the Pension Protection Act, which instructed the Secretary of the Treasury to modify the regulations under section 411(a)(11) to require disclosure of the consequences of failing to defer receipt of a distribution from a defined contribution plan.[6] We strongly recommend that the Service finalize the requirements as proposed. As we stated in our comment letter,[7] the proposal strikes the right balance by alerting the participant that the plan may have investments, or fee structures, different from those obtainable in an IRA, and alerting the participant that more information is available. This approach will not overwhelm the participant with information that obscures the key information while also assuring the participant has access to information consequential to the decision whether to take or defer a distribution from the plan.

Third, we request guidance on the proper tax treatment of escheated amounts from retirement plans and IRAs. In 2004, the Department of Labor ("DOL") issued guidance regarding missing participants in terminating defined contribution plans.[8] The DOL guidance requires that a plan administrator use certain search methods to locate a missing participant, and if all efforts to locate the missing participant fail, then the fiduciary should consider distributing the amounts to a federally insured bank account or escheating them to a state unclaimed property fund. The requested guidance should address certain federal tax implications of escheatment, including (1) whether Form 1099-R reporting is required, (2) whether payors should designate amounts as escheated and, if so, how payors should make such a designation, and (3) whether withholding is required. We have requested this guidance in prior years and we wish to reiterate its importance. We understand that several states have increased their efforts to collect unclaimed property in IRAs and other retirement plans.

Finally, we request guidance complementing the DOL's final regulations on the termination of abandoned plans.[9] This guidance should implement language in the preamble to the DOL's regulations that the Service will not challenge the qualified status of any plan termination under the DOL's regulations or take any adverse action against a "qualified termination administrator" (the party that assumes responsibility for plan distributions and termination), the plan, or any participant or beneficiary of the plan as a result of the termination, provided that several conditions are met.[10] The

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[6] 73 Fed. Reg. 59575 (Oct. 9, 2008).

[7] *See* ICI letter to Internal Revenue Service re: proposed regulation (REG-107318-08), dated January 7, 2009.

[8] U.S. Department of Labor, Employee Benefits Security Administration, Field Assistance Bulletin No. 2004-02, dated September 30, 2004.

[9] 71 Fed. Reg. 20820 (April 21, 2006).

[10] These conditions are as follows: (1) the qualified termination administrator reasonably determines whether, and to what extent, the survivor annuity requirements of sections 401(a)(11) and 417 apply to any benefit payable under the plan; (2) each participant and beneficiary must have a non-forfeitable right to the benefit as of the deemed termination date, subject

guidance also should clarify how parties other than a participant can establish IRAs for abandoned plan accounts;[11] under the DOL's regulations, IRAs for abandoned plan participants could be established by default — without the participant's involvement — in a manner similar to IRAs established under the automatic rollover rules of EGTRRA.

* * *

If we can provide you with any additional information regarding these issues, please do not hesitate to contact Elena Chism at 202/326-5821 or the undersigned at 202/326-5815.

Sincerely,

Karrie McMillan
General Counsel

cc: J. Mark Iwry
George H. Bostick

---

to income, expenses, gains, and losses between that date and the distribution date; and (3) participants and beneficiaries must receive notification of their rights under section 402(f).

[11] *See* Notice 2005-5; Institute Letter to the U.S. Department of Labor, dated March 10, 2003.

Notice 2010-43

JUN 14 2010

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June 11, 2010

VIA EMAIL TO: Notice.Comments@irscounsel.treas.gov

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P. O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Notice 2010-43 – Recommendations on IRS 2010-2011 Guidance Priority List

To Whom It May Concern:

CharitablePlanning.com ("CPC"), a website devoted to charitable estate and financial planning, has the following suggestions for IRS to consider as it identifies and prioritizes tax issues to be addressed through published guidance for the fiscal year July 1, 2010 through June 30, 2011.

1 – Gift/Sale of an Income Interest in a Charitable Gift Annuity to Charity

An income interest in a charitable gift annuity ("CGA") is a capital asset under Section 1221 of the Internal Revenue Code of 1986, as amended from time to time ("Code"). [Note: All references to "Section" shall be to sections of the Code, unless clearly indicated to the contrary.] If the income interest in the CGA were sold, the amount of the gain would be determined under Section 72. To the extent the amount received exceeded the investment in the contract as defined by Section 72(e)(6), it would be included in gross income under Section 72(e)(5)(A).

Section 72, specifically Section 72(e), does not characterize the nature of the gain as ordinary income or capital gain. Although the income interest is a capital asset, some or all of the gain may be characterized as ordinary income if the substitute for ordinary income doctrine applies. See *United States v. Midland-Ross Corp.*, 381 U.S. 54, 57 (1965) and *Commissioner v. P.G. Lake, Inc.*, 356 U.S. 260 (1958).

In May, 2009 the Service issued Rev. Rul. 2009-13, 2009-21 IRB 1029 and Rev. Rul. 2009-14, 2009-21 IRB 1031, which address the tax consequences of selling and buying preexisting life insurance contracts. The sale of an income interest in a CGA is no different than Situation #2 in Rev. Rul. 2009-13.

A significant number of charities today are requesting that donors gift their income interests in CGAs back to the charity, but the gift annuitants are unsure of the tax consequences. If a hypothetical sale would produce capital gain as set forth in Situation #2, then the gift of the income interest is deductible under Section 170 to the extent of its fair market value (which is the present value of the income interest in the CGA, determined according to actuarial tables). On the other hand, if the gain on a hypothetical sale would produce ordinary income, then the donor's deduction would be limited to his or her investment in the contract.

CPC urges the IRS to issue a Revenue Ruling similar to 2009-13 with respect to a gift of an income interest in a CGA. This would promote sound tax administration by clarifying an uncertain area, in a manner consistent with a very similar asset (that is, life insurance), and would be easily understandable by taxpayers. The requested guidance can easily be administered on a uniform basis, similar to life insurance. Finally, this will lessen the burdens on taxpayer and the IRS by resolving an issue that otherwise might be the subject of potentially numerous private letter ruling requests.

2 – An Outright Gift to a Single Member Limited Liability Company ("SMLLC") Solely Owned by a Charity is a Gift to the Charity

Frequently, charities do not want to receive outright gifts of non-cash assets and hold such assets as part of their general endowment, as the asset might produce unwanted liabilities. For example, if a donor wanted to give land and buildings to a charity, the charity may desire to accept the gift in a SMLLC, which limits its liability for environmental issues, casualty losses, etc. At times, a donor may want to make additional contributions to the SMLLC of other noncash assets.

The SMLLC is considered to be an appropriate recipient by a significant number of charities which accept non-cash gifts, so the problem is wide-spread.

Section 301.7701-3(a) of the Procedure and Administration Regulations provides, in part, that a business entity that is not classified as a corporation under Section 301.7701-2(b)(1), (3), (4), (5), (6), (7), or (8) of the Procedure and Administration Regulations (an "eligible entity") can elect its classification for federal tax purposes as provided in Section 301.7701-3 of the Procedure and Administration Regulations. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation under Section 301.7701-2(b)(2) of the Procedure and Administration Regulations) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner.

Section 301.7701-3(b)(1)(ii) of the Procedure and Administration Regulations provides that unless a domestic eligible entity elects otherwise, the entity is disregarded as an entity separate from its owner if it has a single owner. Assuming that a SMLLC does not elect to be treated as separate from its sole member on Form 8832, the SMLLC will be disregarded as an entity separate from its owner.

Unfortunately, no ruling by the Service has ever stated that a gift to a SMLLC solely owned by a Section 501(c)(3) charity is deductible under Section 170 as if the gift were made directly to the charity.

CPC urges the IRS to issue a Revenue Ruling stating that a gift to a SMLLC that is solely owned by a charity is equivalent to a gift outright to the charity. Because this problem is prevalent in the charitable arena, a solution would promote sound tax administration, can be drafted to be easily understood by taxpayers, can be applied uniformly by the Service, and will reduce the burden on taxpayers and the Service.

CPC considers both items of importance to the charitable community, and requests that the Service issue revenue rulings on both topics.

Sincerely yours,

Emanuel J. Kallina, II
Editor-in-Chief
www.CharitablePlanning.Com
Emil.Kallina@charitableplanning.com

Notice 2010-43

Johnson Regina

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
JUN 14 2010

From: Susan Allair [msallair@cwnet.com]
Sent: Friday, June 11, 2010 1:45 PM
To: Notice Comments
Subject: 2020 - 2011 Guidance Priority List

Guidance is requested regarding application of IRC section 1022 (b)(2) to assets acquired from a decedent dying after December 31, 2009 where such assets were held in decedent's qualified revocable trust at date of death.

Guidance is needed in order for trust beneficiaries to properly compute taxable gains and losses in regards to assets acquired from a decedent dying after December 31, 2009 where such assets were held in decedent's qualified revocable trust at date of death.

Guidance should resolve the discrepancy between subsections (b) and (d) of IRC section 1022 in favor of subsection (d) and provide that "estate" as used in section 1022(b)(2) is not limited to the decedent's estate, but is, instead, intended to encompass all property described under section 1022(d)(1).

Thank you for your consideration.

Notice 2010-43

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June 8, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Recommendation for 2010-2011 Guidance Priority List

Dear Commissioner Shulman:

We respectfully request that the Internal Revenue Service (the "Service") and Treasury Department ("Treasury") publish Final Regulations under section 104(a)(2) of the Internal Revenue Code (the "Code") to clarify the scope of the exclusion for damages received on account of personal "physical" injuries or "physical" sickness.

On September 14, 2009, Treasury and the Service issued Proposed Regulations under Section 104(a)(2) to eliminate the requirement that damages received must be based upon "tort or tort-type" rights to be excluded from gross income. However, neither the Code, the Proposed Regulations nor formal guidance from the Service provide a definition of either "physical injury" or "physical sickness."

The boundary line between a physical injury and a nonphysical injury (such as purely emotional distress which the Proposed Regulations exclude from the scope of section 104(a)(2)) is not always clear. However, we believe the Final Regulations should clarify that two specific types of injuries qualify as ***per se*** physical injuries under section 104(a)(2).

Specifically, we request guidance that childhood sexual abuse cases and long-term wrongful incarceration (at least one year of restraint) are ***per se*** physical injuries under section 104(a)(2).

There is a significant body of literature that recognizes childhood sexual abuse as a serious medical problem with long lasting and severe physical manifestations, many of which can only be treated by a licensed medical practitioner or through the prescription of controlled medications. There are similar medical studies that demonstrate the persistent physical damage that results from long-term incarceration.

Appropriateness of Inclusion of Requested Section 104(a)(2) Guidance on the 2010-2011 Guidance Priority List.

Pursuant to Notice 2010-43, the Treasury and the Service consider the following in reviewing recommendations and selecting projects for inclusion on the 2010-2011 Guidance Priority list: (i) whether the recommended guidance resolves significant issues relevant to many taxpayers; (ii) whether the recommended guidance promotes sound tax administration; (iii) whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; (iv) whether the Service can administer the recommended guidance on a uniform basis; and (v) whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

It is respectfully submitted that the requested section 104(a)(2) guidance satisfies each of the criteria enumerated above. Since the amendment to section 104(a)(2) in 1996, taxpayers have been in need of guidance to determine the scope of the terms "physical injury" and "physical sickness." The application of section 104(a)(2) to the victims of childhood sexual abuse and wrongful incarceration affects a large and growing number of taxpayers, in the former case because of greater opportunities for victims to come forward after legislation in many states which extends applicable statutes of limitations and in the latter case because of more widely available DNA-testing to absolve wrongfully convicted prisoners. The requested section 104(a)(2) guidance would promote sound tax administration by providing an understandable tax rule for these victims, thereby minimizing the likelihood of future controversies. It would also provide consistency in tax treatment among such victims who face uncertainties and expense as they attempt to address the issue in an individualized basis.

We would appreciate the opportunity to discuss this issue with you and others from the Service and Treasury. If you have any questions or would like additional information, please contact us at (630) 922-8830. Thank you in advance for your consideration of this request.

Respectfully submitted,

David Shechtman
Drinker Biddle & Reath

John McCulloch
Integrated Financial Settlements

Notice 2010-43

LEGAL PROCESSING DIVISION
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JUN 1 1 2010

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June 10, 2010

Internal Revenue Service
ATTN: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

RE: 2010-2011 Guidance Priority List

Ladies and Gentlemen:

The National Association of Bond Lawyers ("NABL") respectfully suggests the following items for inclusion in the 2010-2011 Guidance Priority List. Section references are to the Internal Revenue Code of 1986, and sections amended by the *American Recovery and Reinvestment Act* ("ARRA"), Pub. L. No. 111-05, are also indicated.

These items are not listed in an internal priority order. Also, by suggesting these priority items, we do not mean to withdraw any of the other items we suggested for the 2009–2010 list.

1. Guidance on the definition of "issue price" under Section 148, particularly focusing on "bona fide public offering," including for purposes of the Build American Bond (BAB) and specified tax credit bond requirements.

2. Finalize solid waste regulations under Section 142.

3. Finalize public approval requirement ("TEFRA hearing") regulations under Section 147(f).

4. Finalize allocation and accounting regulations under Section 141.

5. Guidance on other issues relating to BABs, including treatment of draw-down bonds where draws occur after 2010.

6. Guidance on record retention, including safe harbors as suggested by the Advisory Committee on Tax Exempt and Government Entities (ACT).

National Association
of Bond Lawyers

7. Update Revenue Procedure 97-13 on management contracts under Section 141(b).

8. Guidance on treatment of 501(c)(3) organizations for purposes of the $30,000,000 "bank eligible" limit under Section 265(b)(3), as well as treatment of drawdown bonds under this provision and the provisions set forth under Section 291(a)(3).

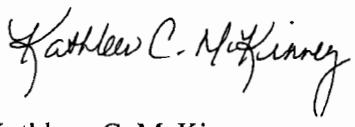
9. Amend the definition of "state or local bond opinion" in § 10.35(b)(9) of Circular 230 to cover opinions relating to BABs under section 54AA, Recovery Zone Economic Development Bonds under section 1400U-2, and tax credit bonds under section 54A.

10. Guidance on refundings of bonds issued under special ARRA provisions expiring at the end of 2010.

11. General guidance as to Recovery Zone Economic Development Bonds and Recovery Zone Facility Bonds under sections 1400U-2 and 1400U-3.

These suggestions were developed by the NABL Tax Committee, chaired by Perry E. Israel of the Law Office of Perry Israel, and have been approved by the Executive Committee of the Board of NABL. If you have any question concerning them, please contact me at kcmckinney@hsblawfirm.com, (864) 240-3243 or Perry Israel at Perry@103law.com or (916) 485-6645.

Sincerely,



Kathleen C. McKinney

cc: Clifford J. Gannett
John J. Cross III
Steven A. Chamberlin
James A. Polfer

Notice 2010-43

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June 11, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Recommendation for 2010-2011 Guidance Priority List – Notice 2010-43

To Whom It May Concern:

The Information Reporting Program Advisory Committee (IRPAC)[1] appreciates the opportunity to recommend items that should be included on the 2010-2011 Guidance Priority List. We request that the Internal Revenue Service (IRS) update its guidance on last known addresses specifically related to business addresses.

IRS Revenue Procedure 2010-16 provides an explanation of how IRS is informed of a change of address. The address of record is crucial as it is the address used for all correspondence including but not limited to notices and refunds of overpayment of taxes.

Many businesses have multiple locations with various functions, e.g. payroll, income tax, information reporting etc, that file returns and receive correspondence from the IRS. Under the current system and processes, the address of record changes each time a return is filed by any of those functions. The end result is notices and correspondence are misdirected within each of those affected companies. That results in errors anywhere from unresolved B-notices to misdirected refunds.

The following are some of examples where this has proved problematic:

- A large bank's payroll tax department received B-Notices for the bank's Form 1099 processing unit
- An outsourced payroll service received notices for a firm's corporate tax obligation

[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.

- A bank's customer, who mistakenly used the bank's address and EIN on a nominee Form 1099, received the banks IRS correspondence

Background

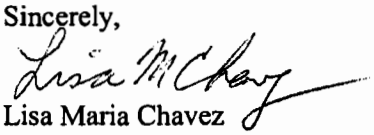
The IRS Business Master File is the repository for Name and Address information for all of the registered business entities within the United States. The current technology employed by IRS only allows one entry for each registered business. Rev. Proc. 2001-18 outlined the IRS process and recently released Rev. Proc 2010-16 provides updated guidance including procedures for electronic and oral address changes. Both revenue procedures apply to individuals as well as businesses and provide the same treatment for both. An increasing number of businesses have decentralized processes causing a greater number of cases of misdirected communication. Historically, when more businesses operated out of one address, the consistent process between individuals and businesses was acceptable. However, through acquisitions and decentralization, this model no longer works.

Recommendations

- IRS should immediately update Revenue Procedure 2010-16 to separate last known address processes between businesses and individuals. For example: current procedure requires that the entity disclose the old address in order to make a change. However, since many businesses have multiple locations the business has no way of knowing which address is on the Business Master File (BMF) record.
- IRS should allow for an indicator on each company's BMF record. That indicator would lock the contact and address information unless an authorized change is made using Form 8822
- Alternatively, IRS should pursue an option where each business form includes a check box that can be used by businesses to indicate that the address should be changed.
- In the event IRS is not able to accommodate the previous recommendations, IRS should consider allowing businesses to opt out of the current procedure of automatic address change with each tax filing. In this case, the business would be required to file Form 8822 to change their business address.
- IRS should accelerate the development of a system that allows for multiple addresses and contacts. The system should also include the ability to directly associate that information with specific IRS functions.

Thank you for your attention to this matter. We look forward to working with IRS to resolve this issue. If you have any questions, please contact the undersigned.

Sincerely,



Lisa Maria Chavez
2010 IRPAC Chair

Notice 2010-43

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NATIONAL ASSOCIATION OF
REAL ESTATE INVESTMENT TRUSTS®

June 10, 2010

VIA E-MAIL [Notice.Comments@irscounsel.treas.gov]

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
1111 Constitution Avenue, N.W.
Washington, D.C. 20024

Re: Notice 2010-43: 2010-2011 Guidance Priority List Recommendations

Dear Sir or Madam:

The National Association of Real Estate Investment Trusts® (NAREIT) appreciates the opportunity, pursuant to Notice 2010-43, 2010-22 I.R.B. 716, to offer our suggestions regarding regulatory guidance to be placed on the 2010-11 Guidance Priority List. NAREIT is the representative voice for U.S. real estate investment trusts (REITs) and publicly traded real estate companies worldwide. Members are REITs and other businesses that own, operate and finance income-producing real estate, as well as those firms and individuals who advise, study and service these businesses.

We request that the Department of the Treasury and the Internal Revenue Service include in their 2010-11 Guidance Priority List the following five issues, listed in order of priority, with the first two items having the greatest priority:

1) clarifying certain regulatory provisions regarding the consequences to REITs to certain "distressed" debt, as discussed more fully in a letter dated August 12, 2009 from NAREIT to then-Deputy Assistant Treasury Secretary Mundaca and Commissioner Shulman;

2) allowing a safe harbor under which non-substantial mistakes and inadvertent errors in computing and making distributions, including potential rounding errors, are disregarded so that those distributions from a REIT are not considered as preferential dividends, consistent with an item on the 2007-2008 and 2008-2009 Priority Guidance Plans "addressing the correction of minor errors by RICs [regulated investment companies] and REITs;"

1875 I Street, NW, Suite 600, Washington, D.C. 20006-5413
Phone 202-739-9400 Fax 202-739-9401 REIT.com

3) clarifying that a REIT's investment in the shares of a money market fund constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A), [1] consistent with an item in the 2009-10 Priority Guidance Plan and in accordance with the recommendations in an April 22, 2009 letter from the American Bar Association Section of Taxation (ABA Tax Section);

4) revising the regulations under section 337(d) concerning "built in gains" so that these regulations do not apply to exchanges of property from a C corporation to a REIT under section 1031 nor to transfers of property to a REIT from a corporation exempt from tax under section 501(a), consistent with an item in the 2008-09 and 2009-10 Priority Guidance Plans, and in accordance with recommendations in a May 1, 2008 submission by the ABA Tax Section; and,

5) interpreting and clarifying provisions of the REIT Investment Diversification and Empowerment Act of 2007 (RIDEA), which was included in the Housing and Economic Recovery Act of 2008 (2008 Act), consistent with an item included in the 2008-09 Priority Guidance Plan.

The reasons for the priority given to the above issues are as follows. First, because of the difficult economic climate, guidance regarding the consequences of distressed debt would help ensure that REITs can work out existing mortgage loans and participate in the market for distressed mortgage loans without jeopardizing their qualification as REITs for federal income tax purposes. Second, the issue regarding inadvertent errors in computing required REIT distributions had been on the Priority Guidance Plan for a number of years and continues to be important to the REIT industry, particularly during the current economic crisis. The other three issues would permit REITs to carry on their business with more certainty and consistent with Congressional intent.

DISCUSSION

I. Distressed Debt

As discussed more fully in the August 12, 2009 NAREIT letter, NAREIT requests guidance that would specifically provide that:

1. the "loan value" of the real property under Treas. Reg. Section 1.856-5(c) securing a mortgage loan held by a REIT is not re-tested upon a deemed exchange under Treas. Reg. Section 1.1001-3, so long as the "significant modification" occurs at a time when the mortgage loan is in default or default is reasonably foreseeable; and,

2. the "amount of the loan" under Treas. Reg. Section 1.856-5(c) for a mortgage loan acquired by a REIT with market discount is the REIT's highest adjusted tax basis during the year.

[1] For purposes of this letter, "section" refers to the Internal Revenue Code of 1986, as amended, unless otherwise indicated.

NAREIT has requested this guidance in order to clarify the treatment of distressed loans and to eliminate uncertainties that are particularly problematic for publicly traded REITs. Given the country's current economic crisis, issuance of this guidance would be particularly timely.

II. Preferential Dividends

There are situations in which a REIT inadvertently, through a "foot fault" such as a rounding error or similar situation, arguably could be viewed as having distributed a non-deductible, preferential dividend. Because these errors truly have no substantive meaning, we again respectfully recommend that the IRS issue guidance providing safe harbors as to these types of situations that will not be treated as preferential dividends, consistent with an item on the 2007-08 and 2008-09 Priority Guidance Plans addressing the "correction of minor errors by RICs and REITs."

Over the past few years, NAREIT and the trade association for mutual funds, the Investment Company Institute, have had a continuing dialogue with personnel from the Treasury Department, the IRS' Financial Institutions & Products group, and the IRS' Large and Mid-Size Businesses division regarding a mutually acceptable resolution to this difficult issue. To that end, in March 2007, we submitted a draft revenue procedure to the IRS. We are re-attaching that draft revenue procedure for your information. This issue remains of paramount importance, and we are hopeful that the IRS and Treasury Department will once again place it on the Guidance Priority List for 2010-2011 and issue guidance in this area in the next year.

III. Money Market Funds as "Cash Items" Under Section 856(c)(4)(A)

Section 856(c)(4)(A) requires that at the close of each calendar quarter of the taxable year at least 75% of the value of a REIT's "total assets" consist of real estate assets; government securities; and cash and cash items (the 75% asset test). On April 22, 2009, the ABA Tax Section submitted comments to the Internal Revenue Service requesting that the Treasury Department and the Service promptly issue guidance clarifying that a REIT's investment in the shares of a money market mutual fund (money market fund) constitutes an investment in a "cash item" for purposes of section 856(c)(4)(A).

As the ABA Tax Section noted:

> [Money market funds] play a pivotal role in the day-to-day operations of many companies, including [REITs], when cash must be readily available to meet the needs of their business. Money market funds are an attractive alternative to interest-bearing checking accounts due to the convenience they provide, their competitive returns, and their regulatory safeguards that are intended to provide liquidity and minimal risk to principal. In light of these features common to money market funds, industry practice for financial personnel and the accounting rules such personnel rely upon generally treat money market funds as "cash items."

NAREIT agrees with the ABA Tax Section's recommendation, especially since the Administration last year took extraordinary steps to assure the stability of money market funds. An item relating to this issue was included in the 2009-10 Priority Guidance Plan.

IV. Revising Final Regulations Under § 337(d) Relating to Conversion Transactions Involving Tax-Exempt Entities

NAREIT reiterates its request for a revision to the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or regulated investment companies (RICs), in accordance with the May 1, 2008 submission by the ABA Tax Section. An item concerning these issues is contained in the 2008-09 and 2009-10 Guidance Priority Lists.

The regulations under § 337(d) implement Congress' directive as part of the repeal of the *General Utilities* doctrine in the Tax Reform Act of 1986 (the 1986 Act) to prescribe such regulations as may be necessary or appropriate to carry out the purposes of the amendments effected by the 1986 Act, including:

> ...regulations to ensure that such purposes may not be circumvented through the use of ... a regulated investment company, real estate investment trust, or tax exempt entity...

Section 337(d).

Prior to its repeal, the *General Utilities* doctrine allowed certain transfers of appreciated property to avoid corporate level tax. The 1986 Act eliminated those rules, effectively preventing the avoidance of corporate-level tax on the disposition of appreciated property.

We support the suggestions made in those comments, and respectfully request that the IRS and Treasury Department revise the regulations under § 337(d) relating to conversions of entities from, and transfers of assets by, C corporations to REITs or RICs, in accordance with those comments.

The ABA Tax Section comments address two specific issues:

First, the ABA Tax Section points out that the § 337(d) regulations technically apply to transfers from a C corporation to a REIT or RIC in an "exchanged basis" transaction and indicates that this treatment is inappropriate. "Exchanged basis" transactions include § 1031 like-kind exchange transactions. C corporations often transfer real property in like-kind exchange transactions when a REIT is the acquirer. These transactions are commonplace, non-abusive, and do not implicate any of the concerns that are properly addressed by the regulations.

Second, the ABA Tax Section states that the § 337(d) regulations improperly treat tax-exempt corporations as "C corporations" for purposes of the regulations. It follows from this treatment that a transfer of assets from a tax-exempt corporation to a REIT or RIC can result in the

imposition of a C corporation level tax with respect to the property (under § 1374 principles if the property is sold by the REIT or RIC within ten years). As the ABA Tax Section points out, this treatment also applies in connection with a transfer of assets from a real estate partnership to a REIT when the partnership has partners that are tax-exempt corporations. Such transfers are undertaken all the time, and for the reasons given by the ABA Tax Section, NAREIT believes that the regulations should not be applied in these situations.

V. Post-RIDEA Guidance

As noted above, the 2008 Act contains several provisions the genesis of which was H.R. 1147 and S. 2002, RIDEA. NAREIT thanks the Treasury Department and IRS for the issuance of guidance thus far in response to both NAREIT's letter of August 13, 2008 requesting certain guidance under 2008 Act and an item contained in the 2008-09 Priority Guidance Plan concerning guidance for REITs under the 2008 Act. NAREIT reiterates its request for guidance relating to the following issues as further described in the August 13, 2008, letter and the follow up letter of Feb. 23, 2009:

1) confirming that dividend-like income such as Subpart F income either qualifies as "good income" under the REIT gross income tests or is excluded from the computation of such tests;

2) delineating how the modified REIT hedging rule in amended section 856(c)(5)(G)(ii) can apply to foreign currency risk management transactions that are not covered by the definition of a "hedging transaction" under section 1221(b)(2)(A), and

3) clarifying that section 856(c)(5)(G)(i) applies to hedging transactions to which the curative provisions of Treas. Reg. § 1.1221-2(g)(2)(ii) (failure to identify a hedging transaction due to inadvertent error) apply.

Furthermore, NAREIT requests that the Treasury Department and IRS issue guidance regarding the treatment of foreign currency gains for qualified business units (QBUs) of a REIT that: a) use a functional currency other than the U.S. dollar; b) but may not meet the quarterly REIT asset tests or the 75% REIT gross income test for a taxable year; and, c) otherwise could apply the principles of the proposed regulations under § 987 issued September 7, 2006 to determine whether that § 987 gain is derived from income that is described in § 856(c)(2) or § 856(c)(3), pursuant to Notice 2007-42, 2007-21 I.R.B. 1288.

Such guidance would be consistent with the legislative history to the 2008 Act, in which the Joint Committee on Taxation noted that that the 2008 Act's approach of excluding "qualified" foreign currency gains from the REIT gross income tests "supersede[s] Notice 2007-42 in the case of remittances from a QBU that uses a functional currency other than the dollar."[2] So long as the QBU meets the quarterly assets tests and the 75% income test for a taxable year, the new provisions exclude from the REIT income tests §987 gain on a remittance from the QBU to the

[2] Joint Committee on Taxation, *Technical Explanation of Division C of H.R. 3221, the "Housing Assistance Tax Act of 2008,"* (JCX-63-08), July 23, 2008, at 44.

REIT, and no tracing-type rules with respect to such §987 gain are imposed, as would have been the case under Notice 2007-42. The Joint Tax Committee then noted that "[i]t is expected that the Treasury Department will use its regulatory authority[3] to provide appropriate rules with respect to the treatment of §987 currency gain for purposes of the REIT gross income tests if a QBU does not meet the requirements of the provision."[4]

****

All of the suggested projects above would fulfill the goals and objectives set forth in Notice 2010-43. First, resolution of these issues would resolve significant issues relevant to the more than 1,000 entities that have elected REIT status and the tens of thousands of taxpayers who invest in REITs.

Second, these projects would promote sound tax administration. Specifically, in the context of how to manage distressed debt, the requested guidance could relieve uncertainties that are potentially paralyzing and avoid the need of REITs to foreclose on a loan because of this tax uncertainty. Furthermore, the preferential dividend project would allow REITs and their taxpayers certainty that minor differences in dividend payments will not result in disproportionate penalties, while simultaneously relieving the Government with having to devote unwarranted resources in negotiating closing agreements to resolve these types of issues.

Third, these projects could clearly be drafted in a manner that would enable taxpayers to easily understand and apply the guidance. We have been working with, and would be pleased to continue to work with, with the IRS in discussing both how the distressed debt guidance and how the preferential dividend guidance could be drafted so as to apply to the most common types of non-consequential "foot faults."

Fourth, we believe that guidance under these projects easily could be administered on a uniform basis. Published guidance on what constitutes preferential dividends is far superior to having to negotiate closing agreements on a case-by-case basis.

Finally, guidance on the requested projects would reduce controversy and lessen the burden on taxpayers or the Service for the reasons stated above.

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[3] Section 989(c) grants the IRS authority to issue regulations under the foreign currency provisions of §§985-989.
[4] Joint Committee on Taxation, *Technical Explanation of Division C of H.R. 3221, the "Housing Assistance Tax Act of 2008,"* (JCX-63-08), July 23, 2008, at 45.

Feel free to contact me or Dara Bernstein, NAREIT's Senior Tax Counsel, if you would like to discuss this issues in greater detail.

Respectfully submitted,

Tony M. Edwards
Executive Vice President & General Counsel

cc: Michael Mundaca, Esq.
Douglas Shulman, Esq.
Jeffrey Van Hove, Esq.
Michael S. Novey, Esq.
Clarissa C. Potter, Esq.
Stephen R. Larson, Esq.

Enclosure

Rev. Proc. 2007-____

1. Purpose

This revenue procedure sets forth a safe harbor under which dividends from a real estate investment trust ("REIT") will not be construed as preferential dividends under § 562(c) of the Internal Revenue Code and will be deemed dividends for purposes of computing the dividends paid deduction.

2. Background

.01. Under § 857(a)(1), the REIT's deduction for dividends paid generally must equal or exceed: (A) the sum of (i) 90 percent of the REIT taxable income for the taxable year (determined without regard to the deduction for dividends paid (as defined in § 561) and by excluding net capital gain); and (ii) 90 percent of the excess of the net income from foreclosure property over the tax imposed on such income; minus (B) any excess noncash income.

.02. A distribution by a REIT is not considered as a "dividend" for purposes of computing the dividends paid deduction if it is treated as a "preferential dividend" under § 562(c). The failure of a REIT distribution to be considered as a "dividend" for purposes of computing the dividends paid deduction could cause the REIT to lose its status as such.

.03. Under § 562(c), a REIT dividend distribution is treated as a preferential distribution unless:

(1) the distribution is pro rata,

(2) the distribution is made with no preference to any share of stock as compared with other shares of the same class, and

(3) the distribution is made with no preference to one class of stock as compared with another class except to the extent that the former is entitled (without reference to waivers of their rights by shareholders) to such preference.

.04. The legislative history of the preferential dividend rule indicates that such rule was meant to prevent income shifting among shareholders of a personal holding company (as defined in § 542), which, by definition under § 542(a)(2), is closely held. *See* H.R. Rep. No. 1860, 75th Cong., 3d Sess. 23 (1938) ("No dividends-paid credit should be allowed in the case of a distribution not in conformity with the rights of shareholders generally inherent in their stockholdings, whether the preferential distribution reflects an act of injustice to shareholders or a device acquiesced in by shareholders, rigged with a view to tax avoidance. . . .The committee believes that no distribution which treats shareholders with substantial impartiality and in a manner consistent with their rights under their stock-holding interests, should be regarded as preferential by reason of minor difference in valuations of property distributed.") In contrast, a REIT, by definition under §§ 856(a)(6) and (h), cannot be closely held.

.05. Under § 1.562-2(a) of the Income Tax Regulations, specific illustrations of preferential dividends are set forth as follows:

(1) A corporation will not be entitled to a deduction for dividends paid with respect to any distribution upon a class of stock if there is distributed to any shareholder of such class (in proportion to the number of shares held by him) more or less than his pro rata part of the distribution as compared with the distribution made to any other shareholder of the same class.

(2) A corporation will not be entitled to a deduction for dividends paid in the case of any distribution upon a class of stock if there is distributed upon such class of stock more or less than the amount to which it is entitled as compared with any other class of stock.

.06. As a general matter, § 1.562-2(a) of the Income Tax Regulations provides that a preference exists if any rights to preference inherent in any class of stock are violated. The three Examples set forth in § 1.562-2(b) of the Income Tax Regulations reflect the focus of the preferential dividend concept on discrepancies in the treatment of different holders of the same class or financially advantaging holders of one class of stock to the detriment of holders of another class of stock. Thus, de minimis and inadvertent errors should not constitute preferential dividends. *See* Hanco Distributing, Inc. v. Commissioner, 32 AFTR 2d 73-5485 (D. Utah 1973).

.07. When a preferential dividend is found to exist, the entire amount of the REIT's dividend distribution that includes the preferential dividend is not entitled to the dividends paid deduction.

3. Scope

This revenue procedure applies to the situations listed below that are recognized as not constituting tax avoidance or other circumstances that the Congress intended to be considered as preferential dividends.

The following examples are illustrative of situations that the Service will not treat as involving preferential dividends as to REITs. The Service will supplement this list as it becomes aware of similar circumstances through private ruling letter requests, fact patterns that are the subject of closing agreements and other sources of information. The Service recognizes that the examples provided in this revenue procedure are not exhaustive. No inference is intended that REIT dividends that are not specifically described in this revenue procedure constitute preferential dividends.

.01. The REIT's charter requires that dividends on preferred stock be declared or declared and paid before any dividends are paid on common stock. However, the board of directors of the REIT declares and pays dividends on the preferred and common stock simultaneously. Alternatively, the REIT's charter provides that dividends with respect to a certain class of shares be paid on a specific date, and either: a) the dividend checks with respect to that class of shares are not all mailed on the correct day, but within several days of one another; or, b) the dividend checks with respect to that class of shares are not all mailed on the correct day, but as soon as the REIT realizes the error, the relevant dividend checks are mailed

(1) In this both situations, no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, the full amount of dividends distributable on the preferred shares, as well as on the common shares, has been distributed, although not in accord with the charter provisions.

(2) In both situations, the only question is timing, and the value of any timing differential is considered to be de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to this dividend.

.02. The REIT's charter provides that dividends on all classes of preferred stock shall be paid semi-annually and before any dividends are paid on the common stock. However, the board of directors adopts a practice of making distributions to the holders of all classes of preferred stock annually and to the holders of all common stock on a monthly basis.

(1) In this situation, no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, the full amount of dividends distributable on the preferred shares, as well as on the common shares, has been distributed, although not in strict accord with the charter provisions.

(2) In this situation, the only question is timing, and the value of any timing differential is considered to be de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to this dividend.

.03. The records of the REIT contain errors regarding share transfers or the identity of its shareholders, either because of internal record-keeping discrepancies or because the shareholders (or their agents or representatives) failed to furnish correct or updated information to the REIT on a timely basis. The REIT thus erroneously pays dividends to some persons who are not shareholders and fails to pay dividends to some other persons who are shareholders. As and when such errors are discovered, they are rectified to the extent practicable.

(1) In this situation, but for such errors no share of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class. Moreover, but for such errors no class of stock has received more or less than the amount to which it is entitled as compared with any other share in any other class of stock. Furthermore, but for such errors the full amount of dividends distributable on the shares has been distributed.

(2) In this situation, such errors are, as and when discovered, rectified to the extent practicable.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends or with respect to any payment made to rectify the errors.

.04. The records of the REIT contain errors regarding the number of shares of one or more classes of stock that are outstanding because of internal record-keeping discrepancies. For example, this situation could occur if REIT employees vest in restricted stock on a certain date, but the REIT's transfer agent is unable to update its records in time to make the correct dividend payment. The REIT thus erroneously fails to pay dividends to some persons who are shareholders. As and when such errors are discovered, they are rectified to the extent practicable.

(1) In this situation, but for such errors no share of stock and no class of stock has received more or less than the amount to which it is entitled as compared with any other share in the same class or any other class of stock. Moreover, but for such errors the full amount of dividends distributable on the shares has been distributed.

(2) In this situation, such errors are, as and when discovered, rectified to the extent practicable.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends or with respect to any payments made to rectify the errors.

.05. The REIT has made all distributions with respect to its classes of stock in accordance with the terms governing the same. When the distributions are made with respect to the shares of stock, rather than any dividend ending up with one or more shareholders receiving a fraction of a cent, there was rounding either up or down to a whole cent.

(1) In this situation, some holders of stock may receive a dividend differential, due to such rounding.

(2) The rounding of a dividend to a whole cent is de minimis.

(3) Thus, there is no preferential dividend paid by the REIT with respect to these dividends.

.06 The REIT's charter provides for classes A, B, and C of preferred stock, as well as for common stock. Dividends on the preferred stock are to be paid before dividends are paid on the common stock. The REIT erroneously fails to pay any dividends on class C preferred stock, although it pays dividends on the other classes of preferred and on the common. The total amount of dividends paid by the REIT is 95% or more of the amount which would have been paid had the REIT paid dividends on the common and on all classes of preferred. As soon as the error is discovered, the REIT pays the amounts that it should have paid on the class C preferred stock, plus an amount in the nature of interest to compensate the Class C preferred stockholders for the delay in paying their dividend.

(1) In this situation, the amount of the errors was de minimis, and the errors are, as and when discovered, rectified. Moreover, the additional amount in the nature of interest payable as compensation for delay in payment of the dividend is intended to treat all stockholders with substantial impartiality.

(2) Thus, there is no preferential dividend paid by the REIT with respect to the dividends which were paid on the class A and class B preferred stock and the common or with respect to the payments made to rectify the error with respect to the class C preferred stock.

.07. The REIT acquires shares of its stock by purchasing them on the established securities exchange on which its stock is listed. Depending on the circumstances of the sellers of these shares, the purchases by the REIT will be treated either as dividends under § 301 or as distributions in redemption under § 302. In both cases, under § 562(b) a portion of the amounts paid by the REIT for the shares would constitute dividends for purposes of computing the dividends paid deduction.

(1) In this situation, only the shareholders who sold their shares to the REIT will be considered to have received dividends from the REIT.

(2) All purchases by the REIT were made on the exchange on which the stock is listed at the market price at the moment acquired.

(3) All shareholders of the REIT had an equal opportunity to sell their shares to the REIT at fair market value. Accordingly, all shareholders were treated with substantial impartiality.

(4) Thus, none of such purchases is considered to result in any preferential dividend.

.08. A REIT, the shares or beneficial interests of which are regularly traded on an established securities exchange ("Exchange"), creates a dividend reinvestment plan (DRIP) for its shareholders and a "cash option purchase plan" (COPP) for both shareholders and non-shareholders (together, the DRIP and the COPP constitute the "Plan"). Under the DRIP, which is available to all existing REIT shareholders of record, shareholders can elect to have the cash dividends that would otherwise be distributed to them automatically reinvested in shares of REIT common stock newly issued by the REIT. Both existing REIT shareholders of record and non-shareholders may participate in the COPP. The purchase date for shares acquired through the DRIP is the date the dividends are paid by REIT and the purchase date for the shares acquired through the COPP is the last business day of the month ("Purchase Date").

REIT regularly pays dividends quarterly. The purchase price of shares of REIT stock acquired under the Plan is determined by an objective multi-day pricing formula that applies equally to participants in both the DRIP and COPP. Under the formula, the purchase price is calculated by multiplying the average daily high and low trading prices (the "Average Price") of REIT's stock reported by the Exchange for a period from I to J business days preceding the applicable Purchase Date ("Pricing Period") less a discount of up to 5 percent that REIT's board of directors has determined to be reasonable. REIT's board of directors can adjust the discount applied to the Average Price in its sole discretion, provided that it cannot alter the discount for a particular Pricing Period after that period has begun. If a day's average high and low trading price of REIT's shares falls below a threshold price on any day of the Pricing Period, that day is ignored for purposes of the multi-day pricing formula. The multi-day pricing period is intended

to minimize unwanted volatility in the purchase price of REIT's shares that might otherwise arise if a fixed-date pricing mechanism were used. Because the pricing formula is based primarily upon an average price that is determined over the multi-day Pricing Period, it is possible that on any given Purchase Date the purchase price of common shares under the Plan may be less than the average high and low trading prices of REIT's shares on such date by more than 5 percent. Conversely, on any given Purchase Date the purchase price of common shares under the Plan may exceed the average high and low trading prices of REIT's shares on such date.

DRIP participants do not have to participate in the COPP, and COPP participants do not have to participate in the DRIP. Participants in either or both portions of the Plan may terminate their participation at any time. Participants are aware of the fixed percentage discount determined by REIT before they agree to participate in the Plan. REIT pays all administrative costs of the Plan, including printing and distributing the Plan prospectus and reports, legal fees incurred in connection with the Plan's preparation, registration fees and transfer agency fees. Administrative costs do not include brokerage fees on common stock purchases because all purchases under the Plan are made directly from REIT. The Plan is designed to enable REIT to raise capital in a cost-efficient manner on a regular, recurrent basis directly from participants in the Plan. By issuing shares through the Plan, REIT is able to avoid investment banking, brokerage, distribution and other costs typically associated with a traditional underwritten equity offering. The Plan also diversifies REIT's shareholder base by enabling retail investors to invest directly alongside REIT's large, institutional investors on a cost-efficient basis. Further, REIT believes that raising capital through the Plan is advantageous as compared to a traditional underwritten equity offering because traditional underwritten equity offerings may be perceived by the market as an indication of REIT's belief that its shares are overvalued, whereas DRIPs and COPPs, because of their continuing, regular nature, minimize any such inference.

(1) In this situation, REIT is treating its shareholders with substantial impartiality, particularly in light of the fact that REIT is willing to sell its shares using the same formula price to non-shareholders under the COPP. In addition, because the pricing formula used to determine the purchase price of shares of REIT stock acquired through the Plan relies on a multi-day average, it is not possible to determine with certainty whether the purchase price will in fact be less than, equal to or greater than the price of the shares on the Exchange on the Purchase Date. If the pricing formula produces a discount of greater than 5 percent of the trading price of REIT's shares on the Purchase Date, such discount will result from market conditions beyond the control of REIT and the Plan participants, and will not be bargained for or intended by such parties. Any discount to participants in the Plan will not be treated as a preferential dividend, but will be a cost REIT would have incurred in issuing its stock under the Plan, and is intended to result in relatively minor differences in the amounts received by shareholders of the same class of REIT shares. The Plan treats all shareholders with impartiality by giving all shareholders an equal opportunity to participate, and any discount provided by the Plan is intended to result in relatively minor differences in the amounts received by shareholders of the same class of REIT shares.

(2) REIT's payment of the administrative costs of the Plan will not constitute a distribution of property to which section 301 applies. The amount of any discount shall not be considered an administrative cost or result in any preferential dividend.

4. Procedure

Dividend distributions made by a REIT that satisfy the safe harbor of Section 3 of this revenue procedure will not be treated as a preferential dividend for purposes of § 562(c).

Notice 2010-43

From: Maria Wong [MWong@aptiumoncology.com]
Sent: Wednesday, June 09, 2010 12:30 PM
To: Notice Comments
Subject: Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
JUN 9 2010

Notice 2010-43

2 Comments:

1. Form W-9, Request for Taxpayer Identification and Certification – The Form W-9 is currently used by taxpayer to provide the information to their customers or clients. The information is mainly their taxpayer identification and type of entity. Such information is then used for the Form 1099 reporting after year end.

    a. Problem - Since the Form W-9 is frequently completed incorrectly by the taxpayers, this has caused the situation of unmatched data for the Form 1099 reporting.

    b. Suggestion – Instead of having a blank W-9 for the taxpayer to fill out, IRS can issue a standard letter to each taxpayer as they register their business and obtain their taxpayer identification number. This letter would show the information that used to be on the Form W-9. The taxpayer can provide a copy of this letter to their customers or clients to facilitate the 1099 reporting later after year end. This would eliminate the situation of having unmatched data on the 1099s.

2. Gift limited to $25 each payee for the tax year – Currently Regs 1.274-3(a) allows taxpayers to deduct gift up to $25 per year given to each individual.

    a. Problem – The $25 limit was established many years ago when the cost of living was much lower. $25 nowadays is not even sufficient to send a bouquet of flowers to a customer or client to show one's appreciation of their business.

    b. Suggestion – Raise the $25 to an amount which is not extravagant and yet a legitimate business gift can be deductible for income tax purposes. For example, the amount for the limit can be raised to $80 or $100.

Please consider the above items for the 2010-2011 Guidance Priority List.

If there are any questions, please contact me at 323-966-3584 Monday through Friday, 9 am to 4 pm. Thank you.

Maria Wong
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Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
JUN 9 2010

From: McCulloch, John [jmcculloch@epssettlements.com]
Sent: Wednesday, June 09, 2010 9:30 AM
To: Notice Comments
Subject: Notice 2010-43
Importance: High
Attachments: Ltr to IRS Commissioner Shulman dated 06 08 2010.pdf

We respectfully request that the Internal Revenue Service (the "Service") and Treasury Department ("Treasury") publish Final Regulations under section 104(a)(2) of the Internal Revenue Code (the "Code") to clarify the scope of the exclusion for damages received on account of personal "physical" injuries or "physical" sickness pursuant to Notice 2010-43. Neither the Code, the Proposed Regulations nor formal guidance from the Service provide a definition of either "physical injury" or "physical sickness." Our proposal is in the attached letter and we specifically seek that childhood molestation and long-term wrongful incarceration be defined as "per se" physical injuries.

Thank you in advance for your consideration of this matter. Should you have any questions, please contact us.

John McCulloch

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June 8, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Re: Recommendation for 2010-2011 Guidance Priority List

Dear Commissioner Shulman:

We respectfully request that the Internal Revenue Service (the "Service") and Treasury Department ("Treasury") publish Final Regulations under section 104(a)(2) of the Internal Revenue Code (the "Code") to clarify the scope of the exclusion for damages received on account of personal "physical" injuries or "physical" sickness.

On September 14, 2009, Treasury and the Service issued Proposed Regulations under Section 104(a)(2) to eliminate the requirement that damages received must be based upon "tort or tort-type" rights to be excluded from gross income. However, neither the Code, the Proposed Regulations nor formal guidance from the Service provide a definition of either "physical injury" or "physical sickness."

The boundary line between a physical injury and a nonphysical injury (such as purely emotional distress which the Proposed Regulations exclude from the scope of section 104(a)(2)) is not always clear. However, we believe the Final Regulations should clarify that two specific types of injuries qualify as *per se* physical injuries under section 104(a)(2).

Specifically, we request guidance that childhood sexual abuse cases and long-term wrongful incarceration (at least one year of restraint) are *per se* physical injuries under section 104(a)(2).

There is a significant body of literature that recognizes childhood sexual abuse as a serious medical problem with long lasting and severe physical manifestations, many of which can only be treated by a licensed medical practitioner or through the prescription of controlled medications. There are similar medical studies that demonstrate the persistent physical damage that results from long-term incarceration.

Appropriateness of Inclusion of Requested Section 104(a)(2) Guidance on the 2010-2011 Guidance Priority List.

Pursuant to Notice 2010-43, the Treasury and the Service consider the following in reviewing recommendations and selecting projects for inclusion on the 2010-2011 Guidance Priority list: (i) whether the recommended guidance resolves significant issues relevant to many taxpayers; (ii) whether the recommended guidance promotes sound tax administration; (iii) whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; (iv) whether the Service can administer the recommended guidance on a uniform basis; and (v) whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

It is respectfully submitted that the requested section 104(a)(2) guidance satisfies each of the criteria enumerated above. Since the amendment to section 104(a)(2) in 1996, taxpayers have been in need of guidance to determine the scope of the terms "physical injury" and "physical sickness." The application of section 104(a)(2) to the victims of childhood sexual abuse and wrongful incarceration affects a large and growing number of taxpayers, in the former case because of greater opportunities for victims to come forward after legislation in many states which extends applicable statutes of limitations and in the latter case because of more widely available DNA-testing to absolve wrongfully convicted prisoners. The requested section 104(a)(2) guidance would promote sound tax administration by providing an understandable tax rule for these victims, thereby minimizing the likelihood of future controversies. It would also provide consistency in tax treatment among such victims who face uncertainties and expense as they attempt to address the issue in an individualized basis.

We would appreciate the opportunity to discuss this issue with you and others from the Service and Treasury. If you have any questions or would like additional information, please contact us at (630) 922-8830. Thank you in advance for your consideration of this request.

Respectfully submitted,

David Shechtman
Drinker Biddle & Reath

John McCulloch
Integrated Financial Settlements

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

JUN 2 2010

From: Tom Wesenberg [Tom.Wesenberg@mppginc.com]
Sent: Wednesday, June 02, 2010 1:43 PM
To: Notice Comments
Subject: Notice 2010-43 priority guidance recommendation

Recommendation for 2010-2011 Guidance Priority List: Scrip and similar programs operated by organizations exempt under IRC 501(c)

The use of scrip programs as fundraisers for schools and other tax exempt organizations has become widespread. Some, though not all, include a feature whereby the purchaser of scrip receives a percentage as a tuition reduction or similar benefit (as opposed to a general benefit to the school). A similar type of program utilizes grocery store cards, wherein interested parties buy groceries with certain cards or accounts, designating a particular 501(c)(3) organization to be benefited by a percentage rebate. Often a portion of these benefits is credited by the charity to the tuition account or other type of account of the individual grocery shopper.

Currently there appears to be little clear guidance regarding the implications of these programs. Clarification and education is needed as to the following issues, at minimum:

1. Private benefit;
2. Unrelated business income taxation.

PLR-118535-09 addressed certain other matters related to scrip (under IRC sections 61 and 170). While its conclusions may suggest some direction regarding the issues listed above, the PLR specifically disclaims any guidance thereon. Accordingly, and with the limitations of PLRs generally, charities are in a position of having little if any authoritative guidance regarding matters crucial to their operations and tax exempt status. Individual participants would also benefit by having more authoritative guidance on these as well as the matters addressed in the PLR.

Given how widespread these programs have become (and in the current economic climate they almost certainly will grow), I request the Department of Treasury and Internal Revenue Service to address these issues within its 2010-2011 Guidance Priority List. (In addition, if organizations have unwittingly jeopardized their exempt status or have generated UBIT and are delinquent, some sort of amnesty program should be provided.)

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LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

JUN 1 2010

Re: Notice 2010-43
Recommendations for 2010-2011 Guidance Priority List

Dear Sir/Madam:

This letter is in response to the invitation for public comment on recommendations for items that should be included in the 2010-2011 Guidance Priority List. I recommend the following guidance projects related to Nonresident Alien (NRA) withholding and Form 1042/1042-S reporting.

- Guidance on how to determine residency status for withholding purposes in the tax year that a foreign national income recipient becomes a resident alien mid-year, but resident status is retroactive to an earlier date during the year

- Practical guidance (including examples) for withholding agents and taxpayers dealing with underwithholding and overwithholding adjustments and timing

Until recently, the IRS's audit and education initiatives regarding NRA withholding and reporting were concentrated in the tax-exempt and financial industries sectors. In the tax-exempt sector, the number of impacted payers and recipients is relatively low as compared to organizations paying U.S. persons. However, the issues regarding the 183-day substantial presence test and tax treaty exemptions can frequently be very complex because many foreign income recipients have multiple visits to the United States in different immigration statuses. In financial industries the number of foreign individual recipients is substantial but most are nonresident aliens because they are outside the United States and their income such as dividends and interest and related treaty issues are simple in comparison to the tax-exempt sector.

With the focus on NRA withholding and 1042/1042-S compliance expanding to include accounts payable functions at for-profit organizations (as well as at tax-exempt organizations), the potential number of organizations and income recipients impacted by the NRA withholding and reporting rules will increase exponentially. Accounts payable administrators not only deal with U.S.-source payments to nonresident aliens and foreign entities outside the United States but also make payments to foreign national individuals in the United States who might become resident aliens in the tax year of payment. In addition, organizations (other than tax-exempt organizations) who routinely employ J-1 exchange visitors and F-1 and J-1 students engaged in post study training are now expected to determine the residency status of their employees and comply with the special payroll rules that apply to those who are nonresident aliens.

1. Tax Residency Determinations

Section 7701(b) of the Internal Revenue Code became effective for tax years beginning with 1985. The rules were written for tax return purposes but applied for all other tax purposes (including withholding and reporting) except estate and gift tax purposes. Under the tax rules, a nonimmigrant's residency start date is retroactive to their first

countable U.S. day in the tax year that they satisfy the 183-day substantial presence test. A nonimmigrant's residency end date is deemed to be December 31 of their tax year of departure from the United States unless they are eligible for and elect to claim an earlier residency end date under the closer connection exception or a tax treaty tiebreaker rule. (The residency end date also applies in situations in which a resident alien becomes a nonresident alien because of a change in residency status such as from H-1B to F-1 student.)

While these rules make sense for tax return purposes when all facts for the tax year are known, they are difficult to apply for withholding and reporting purposes when all facts are not known. (There are no comments in the legislative history of these tax rules about how they should work for withholding purposes.) Administrative personnel who regularly make payments to foreign nationals have many questions about how to apply the retroactive effect of the residency start date, but no official answers.

Payroll administrators typically treat nonresident aliens who will become resident aliens in the tax year as residents from their first countable day in the tax year in order to ensure collection of Social Security and Medicare taxes. Otherwise, employees eligible for the NRA FICA Exception of section 3121(b)(19) would owe a substantial amount of taxes retroactively when they meet the residency change date (typically July 2nd). (Treating these individuals as residents from their first countable day satisfies the IRS audit position.)

Based on discussions on listservs of NRA tax administrators, there is no agreement among administrators about how to treat individuals for NRA withholding purposes who will (or could) become resident aliens in the tax year.

- Should they apply NRA withholding to U.S.-source income payments until the recipient's residency change date (assuming they know from immigration documents when that will occur)?
- Should they treat the individual as a resident from the first countable day in the tax year when they will become a resident alien? (If the organization has the recipient's immigration documents they will know whether the individual is likely to have 183 countable days if the individual is a student or scholar, but not if the individual is a business visitor.)
- If they consistently apply NRA withholding until the recipient is a resident alien, how should they treat an income recipient who is being treated as a resident for FICA purposes?
- Should the rule be different for organizations that know or should know the immigration end date of their payees (such as educational institutions) than for organizations who are unlikely to have the immigration documents of their payees such as financial institutions and accounts payable departments of most organizations? (The latter typically find out about the foreign status of a payee when making the payment.)
- If a recipient is treated as a nonresident alien subject to NRA withholding until the residency change date, should reporting be on a Form 1042-S for the

nonresidency period even though the individual has become a resident alien retroactive to their first countable day?

- If a resident alien is eligible to claim a closer connection exception for an earlier residency end date, can this exception be used for withholding and reporting purposes also? If yes, what form and procedures should the individual submit to the employer or payer use to support the claim?
- If an F, J, or M status student is eligible to claim the closer connection extension (to remain an exempt from counting days individual for more than 5 calendar years), can this exception be used for withholding and reporting purposes also? If yes, what procedures should the individual follow and what documents does the individual need to submit to the employer or payer to support the claim?
- If a resident alien is eligible to claim a later residency start date or earlier residency end date under a tax treaty tiebreaker rule, can this exception be used for withholding and reporting purposes also? If yes, what form and procedures should the individual submit to the employer or payer to support the claim? (At one time, Form 8833 had been designated as a form for withholding purposes.)
- If the recipient has been subject to NRA withholding, should administrators process a refund of overwithheld taxes for recipients who become resident aliens? What if the income is not reportable if the individual is a resident alien (such as taxable scholarships and fellowships)?
- What if a treaty exemption has been allowed and the income recipient becomes a resident alien, abrogating the treaty benefit retroactively? (Under the saving clause of tax treaties, resident aliens are not eligible for benefits under most treaty articles.)
- On a similar note, if a treaty benefit is lost retroactively for prior years because of a retroactive treaty provision, should administrators issue corrected Forms 1042-S (and W-2Cs in the case of employment income for the prior years)?
- Should administrators deny all treaty claims for independent contractor and other payees claiming exemption under treaty articles that are subject to loss under the saving clause who might become resident aliens during the year?

2. NRA Underwithholding and Overwithholding Adjustments

According to the instructions for Form 1042-S (page 14), withheld taxes in box 7 and 9 must be recorded as actually withheld. If the taxes withheld were repaid to a recipient, the amount repaid must be recorded in box 10 but only if the payer is using the amount repaid to reduce a deposit in the following calendar year. Although there are no instructions for Form 1042-S indicating how to record overwithheld tax refunded by March 15 of the following year, IRS Publication 515 states that in the case where reimbursement is made under a setoff (from future amounts owed by the recipient for the tax year) the actual amount of tax withheld is reduced by the repayment.

Underwithholding is frequently discovered at the end of the year. There are no instructions in Publication 515 about how or when to pay underwithheld taxes or how these payments should be deposited or recorded on an individual's Form 1042-S and on the payer's Form 1042 tax return.

IRS Publication 1187, which provides specifications for electronic filing of Forms 1042-S, requires that records be indicated as follows: 0 = correctly withheld, 1 = overwithheld, and 2 = underwithheld.

It would be helpful for NRA withholding tax administrators and taxpayers to have examples of how refunds of overwithholding and payments for underwithholding should be recorded by the payer on the recipient's Form 1042-S and the payer's Form 1042 and by the recipient on their Form 1120F, 1040NR or 1040NR-EZ. Examples should include services income (ECI) as well as FDAP income because they are taxed differently on the recipient's tax return.

- Refunds from the 10 percent allowed to be retained from deposits.
- Refunds using the reimbursement method in which the amount repaid reduces deposits in the subsequent year and is recorded in box 10 of Form 1042-S. (Note that although the actual tax withheld remains in box 7 and 9, there are no instructions for where to record the amount of the repayment on Form 1120F or 1040NR(EZ). For individual tax return purposes, this means that the individual taxpayer actually claims a greater withholding credit than they are entitled to because they are not instructed to net actual tax withheld against any repayments reported in box 10 of Form 1042-S.)
- Refunds using the reimbursement method in which the amount repaid is refunded to the payer as an overpayment on Form 1042 instead of used to reduce subsequent tax year deposits
- Refunds using the setoff method in which case the withheld tax is recorded net of the repayment.
- Payment of underwithheld taxes by the payer by March 15 through a gross-up method with a late deposit.
- Payment of underwithheld taxes by the payer submitted with Form 1042 as the payer's liability for underwithholding, calculated on a grossed-up basis.

Payment of underwithheld taxes by the payer submitted with Form 1042 in satisfaction of the beneficial owner's tax liability and not as additional income of the recipient from whom no tax was withheld inadvertently.

It would be helpful for taxpayers to have:

- Examples of how to complete a Form 1120-F, 1040NR or 1040NR-EZ for effectively connected income on which taxes have been withheld and reported on Form 1042-S 1) without a repayment, 2) with a repayment and net taxes recorded in box 9, and 3) with a repayment and actual taxes withheld recorded in box 9 with a repayment recorded in box 10.

- Examples of how Form 4669 should be completed for payers wishing to reduce their liability for underwithheld NRA withholding by showing evidence

that the recipient submitted a U.S. tax return and paid the tax or made a proper claim for an exemption from tax.

Lastly, it would be helpful to have this information available all in one place in a publication and on the web. This would provide resources for payers who must now determine how to complete the forms properly and would also allow payers to point their vendors to IRS resources which can help them to submit proper tax returns.

Very truly yours,

Paula N. Singer, Esq.
Partner, Vacovec, Mayotte& Singer LLP
Chair, Windstar Technologies, Inc.

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

JUN 1 2010

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June 1, 2010

VIA HAND DELIVERY
VIA ELECTRONIC MAIL

Courier's Desk
Internal Revenue Service
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1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Re: Recommendation for 2010-2011 Guidance Priority List

To Whom It May Concern:

On behalf of American Express Company and pursuant to Notice 2010-43, 2010-22 I.R.B. 1, Miller & Chevalier Chartered respectfully requests that guidance pursuant to Section 4261(e)(3)(C) of the Internal Revenue Code as described below be included on the 2010-2011 Guidance Priority List.

Requested Guidance Pursuant to Section 4261(e)(3)(C)

Guidance is requested under Section 4261(e)(3)(C) regarding the application of the Section 4261(a) domestic air transportation excise tax to the purchase of mileage awards ("Section 4261(e)(3)(C) Guidance"). Specifically, such guidance should provide (i) that payments to air carriers for mileage awards are exempt from the excise tax to the extent the miles purchased are not to be used for "taxable transportation" (as defined in Section 4262); and (ii) a reasonable method (or methods) that may be used at the time mileage awards are purchased to determine the proper allocation between the amounts paid for mileage awards to be used for taxable transportation and those not to be used for taxable transportation (and, therefore, exempt from the excise tax). It is respectfully suggested that the Section 4261(e)(3)(C) Guidance be issued in the form of a notice or a revenue ruling.

Appropriateness of Inclusion of Section 4261(e)(3)(C) Guidance on the 2010-2011 Guidance Priority List

Pursuant to the Notice, the Treasury Department and the Internal Revenue Service (the "Service") consider the following in reviewing recommendations and selecting projects for inclusion on the 2010-2011 Guidance Priority list: (i) whether the recommended guidance resolves significant issues relevant to many taxpayers; (ii) whether the recommended guidance promotes sound tax administration; (iii) whether the recommended guidance can be drafted in a manner that will enable taxpayers to easily understand and apply the guidance; (iv) whether the Service can administer the recommended guidance on a uniform basis; and (v) whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

It is respectfully submitted that Section 4261(e)(3)(C) Guidance satisfies each of the criteria enumerated above. The application of the Section 4261(a) excise tax to the purchase of mileage awards impacts the wide number of purchasers of mileage awards (including credit card companies, hotels, automobile rental companies and others), as well as the airline company sellers of such awards who bear ultimate liability for the tax. Section 4261(e)(3)(C) specifically authorizes rules to exclude from tax amounts attributable to mileage awards depending upon how such mileage awards are used. Since that provision was enacted in 1997, taxpayers have been in need of guidance to determine the appropriate amount of tax applicable to purchased mileage awards. To date, the scope of Section 4261(e)(3) has been the subject of lengthy and controversial examinations. *See, e.g.*, IRS Air Transportation Excise Tax - Audit Technique Guide. Section 4261(e)(3)(C) Guidance would help to resolve significant issues for a large number of taxpayers and promote sound tax administration by providing understandable rules which would apply the tax in a fair and equitable manner and to which both taxpayers and Service examiners could refer, thereby minimizing the likelihood of controversies and the burden on both taxpayers and the Service that they entail. It would also provide a consistency in approach, which for now may be lacking as taxpayers, in good faith, attempt to address this issue, albeit on an individualized basis.

MILLER
CHEVALIER

Thank you in advance for your consideration of this request.

Respectfully submitted,

Donald T. Rocen /MLG

Donald T. Rocen

Marc J. Gerson

cc: Joshua Odintz
John Parcell
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Notice 2010-43

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JUN 1 2010

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

May 18, 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Subject: Recommendations for 2010-2011 Guidance Priority List

Dear Sir or Madam:

I respectfully request the issuance of published guidance under section 468B regarding the tax treatment of a single-claimant qualified settlement fund as a project to be placed on the "2010-2011 Guidance Priority List." This issue first appeared on the "Office of Tax Policy and Internal Revenue Service 2004-2005 Priority Guidance Plan." (See Attachment 1 hereto, Tax Accounting, No. 14, p. 13)

The following dialog between Donna Crisalli, Special Counsel, Income Tax and Accounting, IRS, and the undersigned is excerpted from the unofficial transcript (Attachment 2, pp. 15-16) of the February 23, 2010, IRS hearing on proposed regulations (REG-127270-06) on damages received on account of personal physical injuries or physical sickness. The focus of the hearing was on insurance companies' practices in negotiating settlements with plaintiffs:

> MS. CRISALLI: Let me ask you the question I asked the last speaker, although I'll rephrase it. How do you think we could include a rule like this in a final reg under the APA without having proposed it first, a rule such as you suggest in your written comments?
>
> MR. RISK: I'm not sure, I mean I don't understand the workings of the process as well as you do, but I assume that there's an opportunity for you to restate your proposal.
>
> MS. CRISALLI: Well, we could repropose, yes, and then that would delay the effectiveness of the other rules that we have in there.
>
> MR. RISK: Excuse me, but we're now 14 years into this. *[Referring to the fact that the proposed regulation revision addressed the amendments to Code section 104 brought by the Small Business Job Protection Act of 1996.]*
>
> MS. CRISALLI: Well, I understand.
>
> MR. RISK: And maybe 28 years. *[Referring to the legislative history preceding the enactment of the Periodic Payment Settlement Tax Act of 1982, which codifies that neither actual or constructive receipt nor economic benefit of the amount invested is*

C. The IRS Extends the Section 104(a)(2) Exclusion to Factoring Transactions

In 1999, the IRS formally eroded the constructive receipt doctrine as applied to structured settlements. That year, the IRS held the section 104(a)(2) tax exclusion to apply to monies received by structured settlement recipients for selling their future payments.[197]

The IRS looked back to their earliest structured settlement ruling,[198] noting that the periodic payments were excluded because "the individual had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump-sum amount."[199] However, the 1999 ruling held a factoring company's lump-sum payment to claimant to be of the same "character under §104(a)(2)"[200] as the future payments that claimant would have otherwise received, and therefore excludible.[201]

The 1999 ruling stands in stark contrast to the earlier 1979 ruling, as well as Congress's statements in 1982: "the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments."[202] The IRS's treatment of the proceeds from the factoring transaction portrays structured settlement payments as a secure and alienable asset. But if secure and alienable, it follows that a structured settlement constitutes a constructive receipt of the future stream of income.

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197. See I.R.S. Priv. Ltr. Rul. 1999-36-030 (Sept. 10, 1999); see also Andrada, supra note 36, at 483–84. See generally I.R.S. Priv. Ltr. Rul. 96-39-016 (June 17, 1996) (holding a lottery winner's ability to assign rights to future payments not to constitute constructive receipt).

198. See Rev. Rul. 79-220, 1979-2 C.B. 74.

199. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (emphasis added) (citing Rev. Rul. 79-220, 1979-2 C.B. 74).

200. Id.

201. See id. (declining to decide whether the transaction affected the structured settlement company making the future payments under section 130); see also Andrada, supra note 36, at 487 (noting substantial disagreement regarding the application of section 130 to this scenario prior to the enactment of 2001 legislation). Compare I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (citing Ennis v. Comm'r, 17 T.C. 465 (1951)) (observing that transferred assets are taxable if they are "the equivalent of cash . . . [being] commonly sold or given as a part of a purchase price) (emphasis added), and Rev. Rul. 68-606, 1968-2 C.B. 42 (cited as a limiting case), with I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (explaining that the factoring transaction had become common by 1999 and holding that the structured settlement "was not readily saleable," and thus not equivalent to cash).

202. H.R. REP. NO. 97-832, at 4 (1982) (emphasis added); S. REP. NO. 97-646, at 4 (1982) (emphasis added).

Of course, the IRS did not rule on the legality of the transaction, merely on the proceeds' taxability. The legality of the transaction, or at least the implied legality, would be legislated just a few years later.

D. Federal and State Legislatures Pass Laws Implicitly Approving Factoring

Because of the uncertainty of factoring transactions' impact on the original structured settlement selling company, the insurance industry lobbied against structured settlement purchasing.[203] In fact, NSSTA spent over $1.25 million on lobbying from 1998 through 2001.[204] On the other side,[205] the factoring industry, through its political persona of NASP[206] lobbied to oppose restrictions on settlement purchasing.[207] Naturally, the two sides criticized each other publicly.[208]

Those in Congress and at the Treasury viewed factoring as a contravention of the structured settlement tax subsidy's purpose.[209] As a

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203. Risk, Structured Settlements, supra note 19, at 883.

204. OpenSecrets.org, Annual Lobbying by National Structured Settlements Trade Association, http://www.opensecrets.org/lobby/clientsum.php?lname=Natl+Structured+Settlements+Trade+Assn&year=2009 (last visited Nov. 14, 2009); see Bracy Interview, supra note 28 (stating that the insurance industry "went to war with us, full out, no holds barred war—their purpose was to put us out of business" and indicating that the insurance industry sued factoring companies in state courts for interfering with insurance company contracts, and lobbied state legislatures to outlaw factoring transactions).

205. See generally HINDERT ET AL., supra note 90, § 16.01[3] ("a federal and state legislative contest ensued between those favoring and opposed to factoring structured settlements").

206. NASP is an acronym for the National Association of Settlement Purchasers.

207. Risk, Structured Settlements, supra note 19, at 884; Dyer Interview, supra note 53 ("Both sides spent huge sums of money in an effort to overwhelm the other side."). But see Bracy Interview, supra note 28 ("The view that [section 5891 and state structured settlement protection acts] were designed to punish the factoring industry is ridiculous. It was [the purchasing companies] who made the overwhelming effort to get them approved.").

208. Some of their criticisms will be referred to later in the Article, as they allegedly provide inside information.

209. 1999 Hearing, supra note 15, at 6 (statement of Rep. E. Clay Shaw, Jr.) ("The integrity of the entire system is being undone by factoring transactions . . . leaving [former plaintiffs] in the very predicament that structured settlements were set up to avoid."); id. (written statement of Rep. Pete Stark) (stating that factoring "completely frustrates what our Committee intended when it adopted the original legislation to encourage structured settlements"); id. at 12 (written statement of Joseph M. Mikrut, Tax Legislative Counsel, Department of Treasury) ("These factoring transactions directly undermine the policy objective underlying the structured settlement tax regime, that of protecting the long-term financial needs of injured persons. The factoring transactions also effectively contravene the statutory requirement conditioning favorable tax treatment to the various parties to the arrangement on the injured per-

legislative response to factoring, Senator Baucus recommended a penalty tax on factoring transactions except in court-approved cases in "instances of true hardship of the victim."[210] This legislation, proposed in 1998, would have set a very high standard of hardship.[211] Under the proposal, a court or administrative body would have had to find that "the extraordinary, unanticipated, and imminent needs of the structured settlement recipient or the recipient's spouse or depends render such a transfer appropriate."[212] Such language would likely have resulted in a severe decline in factoring transactions. Others recommended more lenient standards of court approval,[213] such as a best interests standard.[214] Soon after, the insurance and factoring industries agreed to a compromise,[215] proposing a law imposing a 40% excise tax on settlement purchase transactions without court approval.[216]

"Creatively attached"[217] to the Victims of Terrorism Tax Relief Act of 2001,[218] Congress passed the proposed legislation. The Act created section 5891, providing an excise tax of 40% for factoring

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son's inability to accelerate such payments."); 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus) ("I now find that all of this careful planning and long-term financial security for the victim and his or her family can be unraveled in an instant by a factoring company offering quick cash at a steep discount. . . . These structured settlement factoring transactions place the injured victim in the very predicament that the structured settlement was intended to avoid.").

210. 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus); Dyer Interview, supra note 53 (noting that NSSTA lobbied for a standard of financial hardship before 2000).

211. See Structured Settlement Protection Act, H.R. 4314, 105th Cong. (2d Sess.) § 5891(b)(2) (1998).

212. Id.

213. See Andrada, supra note 36, at 494.

214. 1999 Hearing, supra note 15, at 24 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) ("The court should be asking, 'what is in the best interest of the claimant?' ").

215. HINDERT ET AL., supra note 90, § 8A.03[1].

216. Risk, Structured Settlements, supra note 19, at 884 (citing Letter from NSSTA to Hon. Bill Archer and Hon. William V. Roth, Jr., chairmen of U.S. House Ways and Means Committee and Senate Finance Committee (Sept. 13, 2000)). While the factoring industry did not readily accept the court approval process, some thought that it would also benefit factoring companies because the legislation and court approvals would legitimize and secure each transaction. Bracy Interview, supra note 28. Interestingly, though Republicans are typically found on the side of insurance companies, this was not so with respect to section 5891. Because of the Republican ethic of economic liberalism, many Republican congressmen disliked the idea of requiring payees to seek court approval for factoring transactions. In fact, though NASP eventually agreed to the court approval process under the best interests standards, some Republicans still disapproved. Id.

217. Scales, supra note 2, at 918.

218. See Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002).

transactions not approved by a "qualified order,"[219] to be made by an applicable State Court or administrative authority finding the transaction to be in "the best interests of payee."[220] A House report described section 5891 as "[p]rotecting victims who sell structured settlements for a lump sum,"[221] though, as one commentator notes, "the legislation said remarkably little about the now much weakened and nebulous standard that required the factoring transaction."[222] More than simply enacting the excise tax for transactions not approved by courts, the Act also "retroactively immuniz[ed previous] factoring transactions from tax challenges."[223]

Though previous Congressional statements may have suggested antipathy for factoring, and though section 5891 punishes factoring transactions without court approval,[224] the legislation seems to implicitly approve of factoring under certain conditions.[225] NSSTA[226] and

219. I.R.C. § 5891(b)(1) (2006).

220. I.R.C. § 5891(b)(2)(A)(ii) (2006). See generally HINDERT ET AL., supra note 90, § 16.05[4].

221. H.R. REP. NO. 107-801, at 5 (2003).

222. Koenig, supra note 2 at 818.

223. Scales, supra note 2, at 918 (citing Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002)).

224. See I.R.C. § 5891 (2006).

225. See HINDERT ET AL., supra note 90, § 16.03[3][a][i] ("The Victims of Terrorism Tax Relief Act recognizes that unanticipated circumstances, in some cases, justify a transfer of structured settlement payment rights."); Richard Risk, Jr., Attorney Comments on Forthcoming Guidance on Use of Qualified Settlement Funds for Benefit of Single Claimant, 2008 TAX NOTES 30-19, Feb. 28, 2008 [hereinafter Risk, Attorney Comments] ("Since 2002, the payee has a right under Section 5891 to sell future payments, with advance written approval from a state court."); E-mail from Betty Gregware, Sales Executive, John Hancock Life Insurance Company to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 31, 2009, 1:48:48 EST) (on file with author) ("Federal statute 5891 does implicitly approve factoring through directing individuals to the state specific Periodic Payment Protection Act statues [sic] for the requirements regarding how to change their periodic payments, which include court approval."); E-mail from Earl Nesbitt, Executive Director, NASP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (June 19, 2009) (on file with author) [hereinafter Nesbitt E-mail, June 19, 2009] ("Congress and 46 states would not have created laws specifically governing the sale of structured settlement payment rights if they did not want the sales to happen. The fact that they legislated in the area shows that they approve."); Settlement Capital Corporation, Structured Settlements, http://www.setcap.com/edustructuredsettlements.aspx?pt=education (last visited Feb. 19, 2010) ("The passing of . . . IRC 5891 was monumental in establishing our industry's credibility. This law validated our industry and helps plaintiffs gain access to their structured settlement annuity payments. It also clarified that transfer sales are completely tax-free for both the annuitants and the annuity providers."). By passing legislation penalizing only unapproved factoring transactions, Congress's legislation tends to show some degree of approval, at least implicitly.

many others[227] firmly disagree with this view.[228] However, states have shown a desire to allow factoring transactions by passing "transfer acts"[229] giving their courts the power to approve the transactions, thus triggering the section 5891 exemption. Currently, forty-seven states have transfer laws, providing courts the ability to approve transfers under varying guidelines.[230] State courts have been handling

226. NSSTA's counsel maintains that factoring is "fundamentally incompatible with the purposes that structured settlements are intended to serve." Ulman E-mail, Feb. 16, 2009, supra note 39 (noting there might be a very few cases in which factoring would make sense). Ulman takes exception to the argument that the passage of section 5891 somehow implicitly approved of factoring; "To read that as implied approval of factoring is doing a grave disservice to those who passed the law." Id. Asked why Congress did not go further in establishing a barrier to factoring transactions, counsel responds, "Factoring companies are capable of lobbying just as much as anyone else. Section 5891 is the result of legislative compromise." Id.

227. At least one court has held that section 5891 "does not establish a statutory right for such transfers." Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, 2006 WL 3455055, at *2 (N.D. Cal. Nov. 29, 2006) (amended order) (rejecting an argument that a settlement's anti-assignment clause destroys the congressionally created right to factor). In addition, some call the implicit approval assertion "propaganda and misinformation." E-mail from John Darer, President, 4structures.com. LLC, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 26, 2009, 2:30:31 EST) (on file with author) [hereinafter Darer Interview]. Darer argues that section 5891 was legislated "to levy an excise tax to cure abuses in prior years and state exceptions to such a tax." Id. He cites to United States v. Testan, a United States Supreme Court case holding that the legislation of a jurisdictional statute did not simultaneously create a substantive right. 424 U.S. 392, 398 (1976). Thus, section 5891, legislating an excise tax, may not have simultaneously created the substantive right to factor. It should be noted that Testan was a suit against the United States. Because no right to money damages against the United States can exist without a waiver of sovereign immunity, the standard to establish the granting of a right of action may have been higher. See id. at 400–01.

228. The arguments for and against allowing factoring are elaborated upon in the next sub-section.

229. Scales, supra note 2, at 921. These are commonly called Structured Settlement Protection Acts. HINDERT ET AL., supra note 90, § 16.04[1] (providing a table of the various state statutes).

230. HINDERT ET AL., supra note 90, § 16.04[1] (not yet accounting for North Dakota's statute, N.D. CENT. CODE §§ 32-03.4-01 to -13 (Supp. 2009)); Structured Settlement Corporation, supra note 225. In 2000, the insurance and factoring industries worked together, Patrick Hindert, Structured Settlements in 2008—3, BEYOND STRUCTURED SETTLEMENTS, Jan. 31, 2009, http://s2kmblog.typepad.com/rethinking_structured_set/2008/12/structured-settlements-in-2008-3.html, to establish a Model State Structured Settlement Protection Act. The Act was later supported by the National Conference of Insurance Legislators. Id. In the states without protection acts, factoring transactions can still occur. I.R.C. § 5891(b)(2)(B) (2006) (allowing a transfer using the act from the state of the factoring company or life insurance company that issued the structured settlement annuity). Factoring companies do purchase structured settlements in those states. Bracy Interview, supra note 28. Bracy says that the NASP hired lobbyists in almost every state to encourage the legislation of structured settlement protection acts. Id. Of course, this is probably because without those acts, as a result of the newly legislated section 5891, all factoring transactions would face

factoring cases ever since.[231]

Different states have passed differing transfer acts.[232] Some, for example, require the additional finding that the transfer is "fair and reasonable,"[233] in addition to being in the best interests of the payee. Some courts,[234] and in fact some statutes,[235] refuse to approve transfers in excess of certain discount rates. In the end, however, it is well established that the core of a best interest test is judicial discretion.[236] Different judges scrutinize the applicable laws with different focuses.[237] However, this does not mean that state courts infrequently approve factoring transactions. Many in the factoring industry report application approvals of 95% or higher.[238] Moreover, even when

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the 40% excise tax. However, a Former Executive Vice President of NSSTA says that all but one of the forty-six structured settlement protection acts resulted from NSSTA work. Dyer Interview, supra note 53.

231. See generally 321 Henderson Receivables, L.P., v. Martinez, 816 N.Y.S.2d 298 (Sup. Ct. 2006); In re Settlement Capital Cor., 769 N.Y.S.2d 817 (Sup. Ct. 2003); Settlement Capital Corp. v. State Farm Mut. Auto. Ins. Co., 646 N.W.2d 550 (Minn. Ct. App. 2002).

232. Hindert & Ulman, supra note 102, at 19. At least one factoring company has repeatedly attempted "to circumvent state structured settlement protection acts and bind settlement obligors and annuity issuers to arbitrations." Allstate Settlement Corp. v. Rapid Settlements, Ltd., 559 F.3d 164, 172 (3d Cir. 2009).

233. Hindert & Ulman, supra note 102, at 22.

234. See In re Settlement Capital Cor., 769 N.Y.S.2d 817, 829 (Sup. Ct. 2003).

235. E.g., N.C. GEN. STAT. ANN. § 1-543.12(6) (West 2000).

236. Hindert & Ulman, supra note 102, at 22 (citing In re Settlement Capital Cor., 769 N.Y.S.2d 817 (Sup. Ct. 2003)); Interview with Jane Solomon, Supreme Court Justice, New York State Supreme Court, in New York, NY (Jan. 3, 2009) [hereinafter Solomon Interview] (citing broad discretion).

237. Solomon Interview, supra note 236. As counsel for the NSSTA observed, "The 'best interest' standard under state structured settlement protection acts is as stringent, or as lax as judges choose to make it." Ulman E-mail, Feb. 16, 2009, supra note 39; see also HINDERT ET AL., supra note 90, § 8A.04[3] ("In practice, the review of an application for authorization varies greatly with the disposition of the assigned judge."); Nesbitt E-mail, June 19, 2009, supra note 225 (observing, that "[a]t the end of the day, it's the judge," and that there is at least one judge in Texas who has said that he will never approve a transfer, regardless of the circumstances).

238. Milton & Dekruif, Firm Profile, http://www.lawyers.com/California/Glendale/Milton-and-DeKruif-3024685-f.html (last visited Feb. 18, 2010) (reporting a 98% approval rate in over 3,000 transfers); Bracy Interview, supra note 28 (reporting a rate above 95%); Solomon Interview, supra note 236 (reporting approving 75% of applications in 2007). The statistics may be inflated by the fact that applications are sometimes withdrawn. Ulman E-mail, Feb. 16, 2009, supra note 39. It is unclear how many potential purchases factoring companies turn down in order to maintain these high approval rates, though it is substantial. Bracy Interview, supra note 28; see Cravenho Interview, supra note 187 (noting that applications that are likely to be denied are not likely to be made). One broker in the factoring industry reports never having a settlement purchase sale application rejected. Id. (also reporting that at least one company maintains a rejection rate of less than half of one percent). Factoring companies work to push their approval rate as high as possible for two reasons. First,

one's application is denied, a structured settlement owner can typically re-apply without a waiting period, or disclosing the previous denial to the subsequent court.[239] The Pennsylvania Supreme Court has required such disclosure through its rules of civil procedure,[240] and calls have been made for at least one other state's supreme court to do so.[241] Given that the factoring industry currently purchases over $200 million of structured settlements each year, that is hardly surprising.[242]

E. Should Structured Settlement Recipients Be Allowed to Factor?

When considering whether to utilize a structured settlement, claimants will often know of their later ability to factor. In fact, some structured settlement planners always discuss the option with their clients.[243] One such planner calls it a "clear benefit"[244] to his clients, many of whom would not otherwise accept a structured settlement.[245]

An author once likened a plaintiff's decision to delay receiving much of a settlement to the Odyssey's Ulysses binding himself to the mast of his ship so as to prevent his future self from abandoning the vessel and swimming to the Siren's fatal shores.[246] The author comi-

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they typically pay for the application process. These range between $2,000 and $2,500. Bracy Interview, supra note 28; Cravenho Interview, supra note 187 (reporting transaction costs of between $3,000 and $4,000); 1999 Hearing (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting that seeking court approval for a structured settlement could "easily cost the consumer 10% or more . . . in attorney's fees and court costs"). Second, each rejection might have negative consequences. Some like to say that factoring companies have two "customers: the real customer and the judge." Bracy Interview, supra note 28. Both must approve the transfer. Id. Some in the industry predict that the best interests standard will become more strict as judges become more familiar with it. Ulman E-mail, Feb. 16, 2009, supra note 39.

239. Edward O. Burke, Structured Settlement Factoring, 44 ARIZ. ATT'Y 23, 30 (2008) (noting that at least one judge has ordered factoring companies to disclose previous applications).

240. See PA. R. CIV. P. 229.2 (f) (2007).

241. Burke, supra note 239, at 30 (discussing Arizona). The author agrees with such calls.

242. Cravenho Interview, supra note 187. In 2007, one judge reported approving 75% of all factoring transaction applications. Solomon Interview, supra note 236.

243. Meligan Interview, supra note 31. One leading commentator suggests that while some structured settlement advisors will provide advice about factoring, most do not have the knowledge to do so. Hindert E-mail, Sept. 4, 2009, supra note 45.

244. Meligan Interview, supra note 31.

245. Id.

246. Smith, supra note 56, at 1969–70 (citing JON ELSTER, ULYSSES AND THE SIRENS: STUDIES IN RATIONALITY AND IRRATIONALITY 1-111 (rev. ed. 1984)). See generally THE ODYSSEY OF HOMER 242–43 (Allen Mandelbaum trans., Bantam Classics 1990) ("I sealed the ears of my crew in turn. That done, they bound my hands and feet, as I stood upright on the mast box; and they tied the ropes hard fast around the

cally noted, "The difference between Ulysses and the plaintiff in the structured settlement is that, so far as we know, Ulysses did not get a tax break to encourage being bound."[247] Actually, as of the early 1990s, there is another key difference; Ulysses could not untie himself for a given price.

This section describes the reasons for and against allowing structured settlement recipients to factor. The strongest argument for allowing factoring is that persons should be able to respond to changed circumstances. In opposition, however, one must consider the purpose of binding one's future self, and the costs of unbinding.[248] The Article then considers whether allowing factoring renders the tax subsidy ineffective at accomplishing its purpose of discouraging premature dissipation, finding that factoring may strengthen the subsidy's effectiveness.

1. The Right to Factor

No one can predict the future. Though structured settlements encourage one to delay receiving monies so as to protect one's future interest, they also force a claimant to make decisions about how much money he or she will need, and when,[249] often long before such knowledge is available. Thus, the pre-arranged payments likely will not accurately anticipate a claimant's future needs.[250] Where a structured settlement owner, because of such unexpected needs, wishes to make use of their future payments, it would not make sense to prevent them from doing so. Of course, the definition of "unexpected" becomes the central variable in that argument. Through the 1999 legislation, Congress left that decision to the judgment of courts.[251]

One could also argue that Congress should allow factoring to counteract plaintiff attorneys' perverse incentive to inadequately re-

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mast . . . . My heart longed so to listen, and I asked my men to set me free . . . . But when we'd passed beyond the Sirens' isle . . . [t]hey freed me from my mast.").

247. Smith, supra note 56, at 1969–70 (citing ELSTER, supra note 246, at 1-111).

248. Historically, there have also been accusations that the factoring industry used "abusive tactics against the disabled." Randy Dyer, Letter to the Editor, Structured Settlements Need Watchful Eye, N.Y.L.J., Oct. 21, 1999, at 2 (Executive Vice President of National Structured Settlements Trade Association). At least some factoring companies circumvented anti-assignment clauses by directing plaintiff to send a change-of-address notice to the structured settlement company making the periodic payments, and then sign over power-of-attorney privileges to the factoring company, allowing the periodic payments to be deposited by the factoring company. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999).

249. See Luther, supra note 42, at 30.

250. Andrada, supra note 36, at 477.

251. See I.R.C. § 5891 (2006).

present their clients. One author argues that such attorneys may not spend the necessary time to accurately design a structured settlement payment schedule because they operate on a contingency fee basis.[252] So long as the present value of the settlement remains the same, a contingency fee of 30% will produce the same payment whether the payment schedule accurately predicts a clients' needs or not. Thus, the ability to escape the structured settlement plan may compensate for incentivized attorney misrepresentation.

These arguments suggest that Congress should allow factoring, at least sometimes. In addition, positive notions of alienability favor the right to factor. While it is beyond the scope of this Article, some support for claimants' alienability of their future structured settlement payments can be found in the Uniform Commercial Code Revised Article 9,[253] which "has a general purpose of promoting commerce by allowing the pledging and other assignment of payment rights in order to facilitate credit transactions."[254] Evidence for such a position can be found in several sections of the Code's 1999 Revision,[255] and factoring companies have frequently cited Article 9 in asking courts to

252. Andrada, supra note 36, at 477.

253. PAUL J. LESTI, STRUCTURED SETTLEMENTS § 19:11.1. (2d ed. 2008) ("If a state passes the revision to Article 9 of the U.C.C. in its current proposed form, it appears that factoring transactions will be allowed under that state's U.C.C. However, many states that have passed or considered this revision to their state's U.C.C. law have amended it to prevent a person from factoring their rights under structured settlement, workers' compensation and special needs trust arrangements."). Some also cite to the Restatement (Second) of Contracts. See HINDERT ET AL., supra note 90, § 16.02[2][f] (holding that a contract can be assigned unless (a) the substitution of the right would materially change the obligor's duty, burden, risk, or materially reduce the value of his contractual right, or (b) the assignment is ineffective on statutory or public policy grounds, or (c) the assignment is legitimately prohibited by contract) (citing RESTATEMENT (SECOND) OF CONTRACTS § 317(2) (1981)).

254. HINDERT ET AL., supra note 90, § 16.02[2][e] ("When Article 9 was revised in 1999, a major purpose was to expand the range of financial obligations covered by Article 9, and thus eligible for assignment despite contractual anti-assignment language.")

255. U.C.C. § 9-102, Official Comment 15 (2000) ("Note that once a claim arising in tort has been settled and reduced to a contractual obligation to pay (as in, but not limited to, a structured settlement), the right to payment becomes a payment intangible and ceases to be a claim arising in tort."); id. at § 9-406(d)(1) (holding an agreement term between account debtors and assignors ineffective, with exceptions, to the extent that it "prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note"); see LESTI, supra note 253; HINDERT ET AL., supra note 90, § 16.02[2][e]. See generally id. § 9-101 (citing § 9-102 for the definition of a "Commercial tort claim").

ignore anti-assignment language in structured settlement contracts.[256] However, there are substantive counter-arguments to the assertion that Article 9 applies to structured settlement factoring transactions.[257]

2. Factoring Discount Rates

In allowing factoring, it is important to recognize that the cost of factoring to a structured settlement recipient may render such transactions adverse to public policy goals. Again, the purpose of the tax subsidy is to encourage plaintiffs to delay receipt of their money so as to maintain funds for their later life needs. Even if a change in circumstances places the owner of a structured settlement in a difficult financial position, selling their future stream of income at a high discount rate could reduce their award or settlement value so as to guarantee that their later financial needs will not be met.[258]

Historically, discount rates have been very high, even reaching 55%, 65%, and 75%.[259] This means that a structured settlement owner due future payments with a present value of $100,000 might sell the stream of income for an immediate lump-sum of $25,000. Authors point to plaintiffs selling their future payments in desperation as the primary cause of the factoring industry's growth.[260]

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256. HINDERT ET AL., supra note 90, § 16.02[2][e] (specifically noting § 9.318(4) of Article 9 prior to the 1999 Revision, and § 9-109(d)(8) of Article 9 of the 1999 Revision).

257. U.C.C. § 9-109(d)(8) (2000) (holding Article 9 inapplicable to "a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable"); see HINDERT ET AL., supra note 90, § 16.02[2][e]; LESTI, supra note 253, § 19:11. In fact, the majority of states have specifically legislated that Article 9 is inapplicable to structured settlements. HINDERT ET AL., supra note 90, § 16.02[2][e].

258. Goldberg & Mauro, supra note 1, at 64. Of course, the high discount rate may very well result from the structured settlement recipient's lack of other options. See Halpern, Protecting Plaintiffs From the Squandered Settlement, N.C. L. WKLY., Dec. 1, 2008, at 13. Those in the factoring industry agree that claimants selling structured settlements are typically in "dire straights . . . and with no other options." Cravenho Interview, supra note 187. As few as 10% of those selling their settlements are likely not in such an ominous situation. Id. In analyzing the 1999 proposed factoring legislation, the Joint Committee on Taxation acknowledged the argument that "deep discounting of the value of the payment stream may financially disadvantage injured persons that the [subsidy] was designed, in part, to protect." JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

259. Sale of Structured Settlements Received in Tort Claims: Disclosure and Court Approval Requirements: Hearing on S.B. 491 Before the S. Judicial Comm., 1999 Leg. (Cal. 1999) (statement of Sen. Johnston); Andrada, supra note 36, at 472 (citing Mannix, supra note 27, at 66; O'Connell, supra note 27, at A8).

260. Andrada, supra note 36, at 473 (describing factoring as an option of "last resort").

Until recently, discount rates decreased substantially. Though high discount rates of 30% or more were common in the early 1990s, they dropped by half before the end of the decade,[261] averaging between 16% and 18%.[262] The decline continued until the financial crisis in 2008.[263] The average discount rate may have reached as low as 8% or 9%,[264] though some companies continued to charge rates between 15% and 20%.[265] However, after the 2008 financial crisis, average rates rose again to over 14% or 15% within the first few months of 2009, often approaching 20%.[266]

Some argue that high discount rates are a necessary evil.[267] Such authors have pointed to the need for factoring companies to borrow money at high rates,[268] increasing their total capital costs.[269] Clearly,

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261. Scales, supra note 2, at 930 (citing Interview with Earl Nesbitt, Vice President and General Counsel, Settlement Capital Co., in Halladale, Fla. (Oct. 29, 2001)). But see Sale of Structured Settlements Received in Tort Claims: Disclosure and Court Approval Requirements: Hearing on S.B. 491 Before the S. Judicial Comm., 1999 Leg. (Cal. 1999) (statement of Sen. Johnston) (reporting above 50% rates in 1999); 1999 Hearing, supra note 15, at 33 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting an average discount rate of 16% to 22%, but acknowledging discount rates of 30% in some circumstances).

262. 1999 Hearing, supra note 15, at 18 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

263. Bracy Interview, supra note 28.

264. Id. (estimating an average discount rate between 9% to 11%); Cravenho Interview, supra note 187 (estimating an average discount rate between 8% to 10%).

265. Cravenho Interview, supra note 187. Others estimate that the average discount rate in early 2008 was 13%, but climbed to 16% or higher in late 2008, primarily due to the lack of available capital. Nesbitt E-mail, June 19, 2009, supra note 225. Had the crisis not occurred, Nesbitt believes that the rate would have fallen to an average of 12%. Id.

266. Bracy Interview, supra note 28; cf. Cravenho Interview, supra note 187 (indicating rates of 10% to 12% at the beginning of 2009). As noted in the Part III.B., funding for factoring companies has become less available, and thus the price of borrowing such funds has increased. Bracy Interview, supra note 28. As a result, discount rates have increased. Id. Discount rates will also likely be higher for riskier annuities, such as AIG. Still, at least some factoring companies will purchase AIG annuities. Id. (stating that Settlement Capital Corp. will do so). There was a report in 2009, however, that discount rates were available for as low as 7.75%. John D. Darer, If You Have to Sell, Don't Get Ripped Off! Effective Discount Rates as Low as 7.75%, STRUCTURED SETTLEMENTS 4REAL, http://structuredsettlements.typepad.com/structured_settlements_4r/2009/08/if-you-have-to-sell-dont-get-ripped-off-effective-discount-rates-as-low-as-775.html (Feb. 19, 2010).

267. See Scales, supra note 2, at 930.

268. Id. at 931 (citing J.G. Wentworth Amended Registration Statement, at http://www.sec.gov/archives/edgar/data/1047706/0000950115-97-001940.txt (Dec. 11, 1997)) (citing a borrowing rate of 9%).

269. Scales, supra note 2, at 931 (noting capital costs of between 11% and 14%); see also 1999 Hearing, supra note 15, at 33 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (pointing to capital costs as high as 10%

a factoring company cannot offer discount rates below what is required for operating costs. However, although the business model may demand such high rates, its cost to structured settlement recipients could still render factoring a contravention of public policy.

Of course, factoring companies are not forcing themselves on structured settlement recipients. Former personal injury claimants voluntarily enter into such transactions. And, in fact, the factoring industry claims that 92% of claimants who sell their right to future payments are satisfied with their decision.[270] According to factoring industry statistics, these owners likely understand what they are losing. According to J.G. Wentworth, over 70% of surveyed structured settlement sellers received periodic payments for over ten years.[271] Another factoring company reported that over 85% of structured settlement sellers are gainfully employed.[272]

Still, many describe selling as a decision of "last resort."[273] The latter description likely explains why some factoring companies are reporting increased purchasing[274] even as discount rates climb.

3. Undermining and Promoting the Subsidy's Purpose

Having recounted the nature of factoring, we can consider whether allowing factoring truly undermines Congress's purpose in creating the tax subsidy. Clearly, the ability to sell one's structured settlement undermines the self-binding nature of the structured settlement. Equally clear, the significant losses incurred via high discount rates may increase the chances of former claimants requiring later government support, again undermining the tax subsidy's purpose.

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as a result of "not hav[ing] access to traditional sources of capital"). Because the safety net of state guaranty associations may very well not apply to factoring companies, access to capital is more expensive. See Settlement Quotes, A Couple Points, Oct. 30, 2008, http://www.structuredsettlement-quotes.com/blog/?p=171#more-171 (stating that the protections of guaranty associations do not apply to factoring companies).

270. 1999 Hearing, supra note 15, at 20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

271. The #1 Reason, supra note 18.

272. 1999 Hearing, supra note 15, at 35 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the National Association of Settlement Purchasers) (representing that more than 85% of those selling are employed and without long term disability).

273. Andrada, supra note 36, at 473; Bracy Interview, supra note 28.

274. Bracy Interview, supra note 28 (reporting an increase in purchasing volume of 10%). As noted elsewhere, however, decreased access to funding has severely limited the amount of purchasing that some factoring companies can afford. See supra Part III.B.

However, in two equally significant ways, factoring allows the structured settlement tax subsidy to operate and fulfill its purpose of discouraging premature settlement dissipation.

As noted, there is a strong argument for allowing structured settlement recipients to sell their future periodic payments when they encounter unpredicted financial changes. In those situations, factoring does not violate the justification.[275]

Second, for all structured settlement payees, those in financial straits and those not, factoring does not reduce the incentive to structure. It is true that nearly all applications for factoring transactions are approved.[276] But, it is also true that many plaintiffs may utilize a structured settlement only because they learn of the ability to factor.[277] And, it must be remembered that the factoring company is not entitled to the same tax subsidy exclusion of periodic payments as the claimant.[278] As a result, the company's payment to the claimant will not incorporate the value of the tax subsidy.[279] Thus, in choosing to factor, the claimant must sacrifice the monetary encouragement that Congress legislated to encourage the use of structured settlements. Though factoring allows claimants to alienate the future rights that Congress hoped they would not, the tax subsidy continues to operate, discouraging them from doing so.

In fact, the ability to factor likely supports the tax subsidy's goal by encouraging the use of structured settlements. Before factoring became common, several commentators noted that the inability to alienate one's future payments was a strong disadvantage to the structured settlement.[280] This is no longer the case. Practitioners have noted that the increased flexibility of the modern structured settlement makes their use more likely,[281] though only 5% actually end up factoring.[282] Thus, while it is true that Congress's implicit approval of factoring,

275. It could be argued that one's knowledge of the ability to factor in the case of financial challenge renders one more likely to end up in financial straits.

276. See supra note 238.

277. Meligan Interview, supra note 31. But see McCulloch E-mail, supra note 17 (referring to factoring "not [as] a right, but rather a right to ask").

278. E-mail from Matt Bracy, General Counsel of Settlement Capital Corp. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law, Apr. 15, 2009; see I.R.C. § 104(a) (2006).

279. The lost tax subsidy is reflected by the proportionately higher discount rate. While the former claimant does not pay tax on the lump-sum purchase amount received from the factoring company, it indirectly does so through the discount rate, which must reflect the income tax cost to the factoring company for receiving the future payments.

280. E.g., Yandell, supra note 50, at 73.

281. E.g., Meligan Interview, supra note 31.

282. Nesbitt E-mail, Sept. 11, 2009, supra note 183.

after court approval, substantially erodes the application of the constructive receipt doctrine to structured settlements, doing so may very well further public policy ends.[283]

F. Looking Back at Where Congress Began

Consider where the exclusions for structured settlements began. One revenue ruling allowed a structured settlement recipient to exclude the periodic payments, after noting that the recipient had no rights to the annuity itself.[284] A second revenue ruling allowed the exclusion of periodic payments because plaintiff received "neither actual nor constructive receipt, nor the economic benefit of the present value of the damages."[285] Three years later, the committee reports for the Periodic Payment Settlement Tax Act of 1982 stated, "the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments."[286]

Clearly, the 1988[287] and 2001[288] enactments relaxed the application of the constructive receipt and economic benefit doctrines to structured settlements. Plaintiffs can hold greater rights to their periodic payments than general creditors,[289] and sell those rights for their present value upon a state court's approval. As the constructive receipt and economic benefit doctrines relate to the claimant's level of control over the settlement monies, it seems logical to assert that the deconstruction of the two doctrines contravenes Congress's stated goal of preventing claimants from quickly dissipating their settlements. Simply stated, monies cannot be prematurely dissipated unless they are received, or the right to receive them in the future is alienable.

However, though a structured settlement recipient has been given greater and more flexible rights with regard to their expected future periodic payments, the strong incentive of the tax subsidy endures.

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283. It is important to remember that where court approval is a rubber-stamp, rather than the result of substantive consideration, the argument may fail to hold. See supra Part III.D.

284. Rev. Rul. 79-220, 1979-2 C.B. 74.

285. Rev. Rul. 79-313, 1979-2 C.B. 75.

286. H.R. REP. No. 97-832, at 4 (1982) (emphasis added); S. REP. No. 97-646, at 3 (1982) (emphasis added).

287. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A)-(B), 102 Stat. 3342.

288. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002).

289. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342.

Personal injury victims considering the use of a structured settlement are now encouraged by the increased security of their future payments, due to the 1988 amendment, as well as the alienability of their future payments, due to the 2001 legislation. In considering whether to sell one's payments however, the created subsidy operates to incentivize against doing so.

IV.
HELPING THE WRONG PARTY

Thus far, this Article has demonstrated the initial applicability and subsequent erosion of the constructive receipt and economic benefit doctrines as applied to structured settlements. This Part provides the context for the most recent, and quite substantial continuation of these two patterns: the use of qualified settlement funds in single-claimant cases, to be discussed in Part V. As will be shown, qualified settlement funds in single-claimant cases are sometimes used to circumvent a defendant's or liability insurer's ability to reap a substantial portion of a structured settlement's monetary benefits. This section describes the three ways that defendants and liability insurers can do so, and argues that such an ability may contravene Congress's purpose in subsidizing structured settlements.[290]

A. Capturing the Monetary Benefits of a Structured Settlement

Proponents of structured settlements often speak of a structured settlement's ability to benefit both sides, allowing plaintiff to receive more, while defendant pays less.[291] Defendants are able to capture much of the benefit resulting from the use of a structured settlement. Likely for this reason, those inside and outside the industry believe that the structured settlement was either a "defense tactic"[292] from the beginning,[293] or became one thereafter.[294] Often represented by their

290. Of course, benefits accrue to defendants and liability insurers without the subsidy. However, the subsidy increases the benefits by increasing the overall number of structured settlements.

291. See, e.g., Scales, supra note 2, at 880–81; Goldberg & Mauro, supra note 1, at 39; A Roundtable, supra note 10, at 70 (comments of Roger Warin).

292. Risk, Structured Settlements, supra note 19, at 868.

293. Id.

294. Scales, supra note 2, at 897 (Scales reports being told by a major multi-line insurer when researching the structured settlement that it has been "a defense product from the beginning"). In 1999, the factoring industry argued that insurance companies use structured settlements to reduce costs. 1999 Hearing, supra note 15, at 36 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the NASP). NASP presented evidence from an insurance company's manual; "The primary objective in expanding the use of structured settlements is to maxi-

insurers during settlement negotiations,[295] defendants have enjoyed the advantages of experience, partly as a result of being "repeat players."[296] As a consequence, some argue that "physically injured victims often are victimized a second time, unknowingly to them, when the settlement is made."[297] Over the years, estimates of defense-side savings have decreased from between 50% and 75% in 1974,[298] to between 20% and 40% in 1978,[299] and recently to between 20% and 25%.[300] The decline is likely a result of plaintiff lawyers' increased

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mize their value as a tool to reduce both claim loss and expense costs." Id. (quoting The Travelers Structured Settlement Manual). The factoring industry also cited to a telling trial transcript. In the cited trial, counsel to State Farm argued that one of the structured settlement tax exemption's purposes is to protect the plaintiff. Id. at 33 (citing Transcript of Record, Stone Street Capital v. Jackson, Civ. No. 176131). The court admonished, "No it is not. The reason for setting up these structured payments are so that the insurance companies can settle out cheaper." Id. at 34. When counsel tried to respond, the court interrupted, "That is the reason. That is the reason." Id. With these and other examples, the factoring industry argued that NSSTA's antagonism for the factoring industry was based on the industry educating the public about the true value of structured settlements. Id. at 33 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the NASP). Similar remarks were made in contemporary articles. James D. Terlizzi, Perspective, Understand Structured Settlement Refinancing Issues, N.Y. L.J., Sept. 27, 1999, at L7, L15 (General Counsel and Chief Operating Officer of Peachtree Settlement Funding of Norcross, Ga., a factoring company).

295. Goldberg & Mauro, supra note 1, at 35–36.

296. Smith, supra note 56, at 1972. Commentators complain that claimants' attorneys often allow defendants or defendants' insurers to control the structuring of the settlement. See Risk, Structured Settlements, supra note 19, at 887. However, this problem may be diminishing, as plaintiff attorneys become increasingly assertive in the structuring of their clients settlements. See id. at 901. Guides to plaintiff lawyers warn readers to guard against some of defense practices discussed above. See STEPHEN J. HERMAN, Personal Injury Settlements, in PLAINTIFF'S PERSONAL INJURY FROM START TO FINISH 94 (2006).

297. Risk, Structured Settlements, supra note 19, at 888. Risk argues that plaintiffs are legally entitled to the tax subsidy, see id. at 892, and reports, "Many plaintiff attorneys who rightly were concerned over their own exposure to a legal malpractice claim by allowing the adversary to handle this transaction on behalf of their client simply had their clients take the cash." Id. at 892.

298. Choulos, supra note 21, at 74 (citing Wallace E. Sedgwick & William C. Judge, The Use of Annuities in Settlement of Personal Injury Cases, 44 INS. COUN. J. 548 (1974)).

299. Periodic Payments Prove Aid to Accident Victims, J. COM. & COM., Mar. 20, 1978, at 8 (quoting Kenneth Wells, a consultant at Walker, Sullivan and Co. of Los Angeles).

300. Scales, supra note 2, at 882; see also Risk, Structured Settlements, supra note 19, at 870; JOINT COMM. ON TAXATION, 106TH CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999) ("[A]nother possible outcome is that the defendant could spend somewhat less . . . and purchase an annuity as part of a structured settlement arrangement that would pay the recipient . . . [less] annually for the rest of his or her life. Under this scenario, the recipient would be indifferent as between choosing the structured settlement arrangement and receiving a

familiarity with structured settlements and the use of plaintiff-side brokers.[301] Of course, these estimates are just that, estimates.[302] The author was unable to find any empirical support.

Whether or not such savings occur frequently today, defendants and liability insurers have proven themselves capable of utilizing the structured settlement to minimize[303] their damages in three ways: (A)

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lump sum payment of [more money]. . . . However, the defendant would save [a substantial amount] in expenditures to settle the case.").

301. HINDERT ET AL., supra note 90, § 1.04[4] ("During the early development of structured settlements, defendants maintained an information and resource advantage over plaintiffs, a condition that dissipated in the 1990's.") (citing Rudnitsky & Blyskal, supra note 9, at 29); NSSTA Letter, supra note 14, at 3 (asserting that both defendants and plaintiffs generally have brokers); Darer Interview, supra note 227 (noting that while some plaintiffs may agree to a structured settlement without a structured settlement expert, such cases are becoming increasingly rare, as their attorneys become educated on the increasing complexity of settlement planning issues and bring in settlement consultants as part of the team). See Bracy Interview, supra note 28 (stating that plaintiff attorneys and plaintiff-side brokers became more aware of structured settlements about ten years ago, and that both plaintiffs and defendants often have brokers); Ulman E-mail, Feb. 16, 2009, supra note 39 (noting that claimants attorneys have become more knowledgeable about structured settlements).

302. Some question whether defendants truly save money by using structured settlements at all. E-mail from Patrick J. Hindert, Managing Director, S2KM Ltd., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law. (Aug. 17, 2009, 8:33:00 EDT) (on file with author) [hereinafter Hindert E-mail, Aug. 17, 2009]. They ask two important questions. First, "Where is the independent, objective proof?" Id. And second, "Why would an informed plaintiff attorney ever knowingly accept a lower fee from his client for a structured settlement costing defendants less than an alternative cash settlement?" Id. The author could find no data to answer the first question. However, the second question can be answered. Calculating the alternative fees from a structured versus lump-sum settlement may be outside of the plaintiff attorney's abilities. Where defendants do save money, that same commentator lists the primary reasons as "1) misrepresentation, 2) failure to disclose; or 3) negotiation pressure." Id. Thus, he recommends that plaintiff attorneys be "more aggressive in discovery to elicit information from defendants about structured settlement compensation, conflicts of interest, and company policies as well as more accurate cost and present value calculations." Id. ("If you ignore profits from product sales and assume full disclosure of compensation and costs with no misrepresentations and no unauthorized practice of law (agents providing legal services to save defendants legal costs), I don't see how defendants save money using structured settlements.").

303. It may be more accurate to describe defendants as minimizing damages, or offsetting costs, rather than "saving" through these three strategies. Some disagree with the characterization of these practices as "savings." E-mail from Richard B. Risk, Jr., Attorney, Risk Law Firm, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Aug. 15, 2009, 12:16:27 EST) (on file with author) [hereinafter Risk E-mail] (using language such as "bridging the gap" or "offset[ting] the cost of settling a claim"). However, the term "saving" is used here simply to mean that defendants end in a financially superior position by using a structured settlement than by using a lump-sum. This is done by either paying less, or by recouping some of their payment by profiting elsewhere.

negotiating future payments based on nominal, rather than real value, (B) profiting through the purchase of the structured settlement annuity, and (C) negotiating to benefit from the tax subsidy.[304] Based on the research below, the author concludes that defendants and liability insurers do minimize settlement costs through structured settlements today. Because the tax subsidy encourages structured settlements, it makes the first two cost minimization methods more available.

1. Negotiating on Nominal Terms

Due to inflation, one dollar in ten years is worth far less than one dollar today. If invested prudently, one dollar today will increase in value faster than inflation. Thus, a defendant who can promise plaintiff $100,000 spread out in monthly payments over ten years is far better off doing so than paying plaintiff $100,000 in cash today. As will be shown below, defendants prefer to negotiate in terms of future nominal dollars, rather than present value. Defendants have been utilizing this strategy, called a "short-changing scheme"[305] by a court of law, for over four decades.

Many have documented defendants and their insurers not disclosing the present value or cost of the structured settlement to plaintiff in the past.[306] By withholding such information, defendants deceive[307]

304. The frequency of these strategies being successfully practiced today will be discussed. One settlement planner believes them to be practiced "rarely," "frequently," and "occasionally," respectively. E-mail from Jack L. Meligan, Plaintiff Loyal Settlement Planner, Settlement Professionals Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Aug. 20, 2009, 3:54:43 EST) (on file with author).

305. Macomber v. Travelers Prop. & Cas. Corp., 804 A.2d 180, 186 (Conn. 2002); see Lyons v. Med. Malpractice Ins. Ass'n, 730 N.Y.S.2d 345, 346, 286 A.D.2d 711, 712 (N.Y. App. Div. 2001) (reversed and remanded on the factual issue of insurer representation after finding privity between a plaintiff and defendant for purposes of the represented value of the structured settlement).

306. See Andrada, supra note 36, at 471–72; ROBERT W. WOOD, TAXATION OF DAMAGE AWARDS AND SETTLEMENT PAYMENTS § 7.24 (3d ed. 2005) [hereinafter WOOD, TAXATION OF DAMAGE AWARDS]; LESTI, supra note 253, § 1:2; Risk, Structured Settlements, supra note 19, at 888; Frolik, supra note 55, at 573–74; 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of NASP); id. at 34 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding); A Roundtable, supra note 10, at 76 (comments of Herb Cumming). But see NSSTA Letter, supra note 14, at 3 ("Industry practice is to provide the claimant and counsel with a detailed factual presentation regarding the cost of various components of the settlement, including the annuity cost and total future payout for the structured payments. Industry practice is to spell out the annuity cost as part of the settlement offer. Plaintiff's counsel has to know the cost of the structured settlement annuity in order to calculate the attorney's fee, which must be determined on the basis of the present value of the settlement."). Some in the insurance industry argue that it is not difficult for a plaintiff attorney to learn the

plaintiffs into believing that the settlement is worth more than its true value.[308] For example, one case regarded the representation by the Medical Malpractice Insurance Association to plaintiffs that a structured settlement package, including an annuity providing for payments of $3,000 per month for life to an infant, carried a present value of $940,180.[309] In fact, the package's true present value was $410,000.[310]

In the past, the insurance industry has taken steps to maintain plaintiffs' lack of present value information. It has done so both through misinformation and political action. For years, defendants and insurers maintained that plaintiffs and their attorneys could not know the present value or cost of a structured settlement without breaching constructive receipt.[311] Such receipt would prevent plaintiff from utilizing the tax benefit of section 104(a)(2). This has been held untrue.[312] Later, defendants and insurers also asserted that involve-

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present value of an offered structured settlement. See Dyer Interview, supra note 53. Though a broker providing such information may not earn a commission by advising in that transaction, he or she will often advise anyway, hoping to make commissions on the requesting attorneys' subsequent settlements. See id.

307. Some commentators find defendants' representation of structured settlements' values to constitute fraud. Risk, Structured Settlements, supra note 19, at 889. Others simply argue that a claimant's attorney should always know the cost to defendant. See A Roundtable, supra note 10, at 76 (comments of Lawrence Charfoos); id. at 76 (comments of Herb Cumming).

308. See Andrada, supra note 36, at 471–72; WOOD, TAXATION OF DAMAGE AWARDS, supra note 306, § 7.24; LESTI, supra note 253, § 1:2; Goldberg & Mauro, supra note 1, at 44; Frolik, supra note 55, at 573–74; 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of NASP); id. at 34 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the National Association of Settlement Purchasers); Terlizzi, supra note 294, at L7 (General Counsel and Chief Operating Officer of Peachtree Settlement Funding of Norcross, Ga., a factoring company); A Roundtable, supra note 10, at 76 (comments of Herb Cumming). However, Cumming noted that plaintiff attorneys had a relatively new tool available, Merrill Lynch's Total Agreement program, which enables a plaintiff attorney to "determine the value of a case and then to consider what income stream that money could provide to best meet the needs of the client, given his or her age, family situation, and so forth. . . . The present day value or cost of a settlement need not be a secret anymore." Id.; see also id. at 80 (comments of Charles Krause).

309. Lyons v. Med. Malpractice Ins. Ass'n, 730 N.Y.S.2d 345, 346 (N.Y. App. Div. 2001).

310. Id.

311. E.g., Joseph E. Murphy, Structured Settlements, THE VERDICT, Oct. 1986, at 11 ("It is of the utmost importance that in describing such an annuity, the purchase price of the annuity not be mentioned but simply the schedule of payments."); cf. Gregware Interview, supra note 17 (stating that over fifteen years ago, it was widely believed that claimant knowledge of present value would constitute constructive receipt).

312. See I.R.S. Priv. Ltr. Rul. 90-17-011 (Jan. 24, 1990) ("[T]he exclusion from gross income does not apply to punitive damages in connection with a case not result-

ment of a plaintiff broker in structured settlement negotiations constitutes constructive receipt.[313] Commentators have argued that this is false as well.[314]

The insurance industry has also worked to prevent plaintiff-side support for structured settlement negotiations from growing. One commentator argues, "Although [NSSTA's] mission statement does not overtly exclude plaintiff advocates, NSSTA was organized by those who wanted to preserve the structured settlement concept as a defense tool."[315] For example, in 1999, NSSTA worked to defeat proposed legislation in both Florida and New Hampshire that would have allowed structured settlement plaintiffs to select their broker and funding structure.[316] Members of NSSTA have acted similarly. From early on, commentators report, "annuity issuing life insurance companies . . . restricted their appointments to those brokerages (general agencies) that would prohibit their individual agents from working on behalf of injury victims and their attorneys."[317] While many of these tactics are no longer employed, others allegedly continue.

Currently, there is a class action against Hartford Financial Services Group alleging that Hartford's liability insurer subsidiaries "operate in tandem [with inside and outside brokers] to deliberately erect an information barrier to protect defense interests."[318] Plaintiffs also allege that Hartford and its in-house brokers "colluded to submit falsely inflated cost information to unwitting injury claimants (and their attorneys when retained) about the true amount of money which Hartford invests to purchase the funding annuity."[319]

There is some question as to the frequency of this practice occurring today. As one attorney puts it, "Today, only a very naïve attorney would not insist on knowing the cost of the proposed settlement on behalf of a client. Unrepresented claimants, however, might still be

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ing in physical injury or physical sickness."); see also I.R.S. Priv. Ltr. Rul. 83-33-035 (May 16, 1983) ("[Y]ou will have neither actual nor constructive receipt, nor the economic benefit of the present value of the amount invested in the annuity, and the periodic payments will be excludable from your gross income under section 104(a)(2) of the Internal Revenue Code.").

313. Risk, Structured Settlements, supra note 19, at 894.

314. Id. at 895.

315. Id. at 881.

316. Id.

317. Id. at 882.

318. Plaintiff's Class Complaint at ¶ 41, Doc. 1, Spencer v. Hartford Fin. Serv. Group, (No. 3:05-cv-01681-JCH) (D. Conn. Oct. 31, 2005). The complaint alleges that Hartford's liability carriers "typically do not reveal to injury claimants (or their attorneys) any information about the commission agreements they have with their appointed brokers." Id.

319. Id. at ¶ 43.

misled and taken advantage of by this tactic."[320] Thus, the occurrence of this strategy, as opposed to the subsequent two, may be rare.[321]

2. Defendants' Insurers Can Profit from Structured Settlements

Where the casualty insurer is part of a larger insurance company, which also holds a life insurance company, the insurer can profit by purchasing an annuity from its affiliate. Plaintiff representatives report cases of defendants' insurers refusing to structure a settlement unless the annuity was purchased from the company's approved list of life insurance companies.[322] Unfortunately, that list might exclusively consist of affiliate companies, and non-affiliated companies with substandard annuities.[323]

Internal insurer memos published show that some insurers have done their best to purchase from affiliates in the past.[324] Where the

320. Risk E-mail, supra note 303.

321. See Meligan E-mail, supra note 304 (suggesting that it is "rare").

322. E-mail from Lawrence Grassini, Partner, Grassini & Winkle, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 20, 2009, 15:07:38 EST) (on file with author) [hereinafter Grassini E-mail] (noting a case within the last few years); E-mail from Ritch McBride, President, Plaintiff-Quote.Com, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 23, 2009, 14:46:22 EST) (on file with author) [hereinafter McBride E-mail].

323. Grassini E-mail, supra note 322 (discussing such a case); McBride E-mail, supra note 322. One might respond that liability insurers would always wish to find the best priced annuity so as to limit costs. However, some argue that the benefit of directing business to an affiliate or friendly life insurance company is sometimes greater. Id. Life insurance companies' approved lists are sometimes available. For example, AIG's 2007 list of approved life insurance companies included its two affiliates, American General Life Insurance Co., American International Life Assurance Co. of NY, and four other life insurance companies: Allstate Life Insurance Co., Hartford Life Insurance Co., New York Life Insurance Company, and Pacific Life and Annuity Co. Robert Peahl & Michael Miller, Webcast Seminar, Single-Claimant 468(B) Trusts, http://web.aig.com/2007/lit6458/lit6458_AIG468(B)%20Presention_v2.PPT (last visited Feb. 19, 2010).

324. E-mail from Nacado King to Alfred W. Bodi et al., cc to Kharyne Neptune, Contemporary National Director of Structured Settlements, AIG (Mar. 5, 2005, 09:44 AM), available at http://www.settlepro.com/data/AIGSSPolicyMemo.pdf (emphasis added) ("Our recommended quoting practice is as follows: Our preferred method of negotiating a case is to make all offers in the form of a structured settlement. . . . When the case settles for an agreed upon dollar value with the understanding that a portion of the settlement will be placed in a structure, then the broker should place the premium with AG or AI Life. Unless compelled by the plaintiff or the plaintiff's broker to illustrate competitiveness, the broker need not canvas [sic] the Approved Life list for the best quote. If compelled, the broker must canvass the Approved List for the best available rates. The broker, however, must give AG or AI Life the last right of refusal."). It is unclear if the policy is still in effect. The author has spoken to some in the industry who believe the policy to remain unchanged. Others say that while there may have been historical significance to the memo at one time, there have

market is not fully searched, the claimant can end up with an inferiorly rated annuity.[325]

Even if the casualty insurer is not part of a larger insurance company, it can profit by structuring a settlement through the chosen broker. Since 1979, liability insurers have developed relationships with structured settlement brokers and brokerage companies.[326] A liability insurer might almost exclusively hire those particular brokers,[327] refusing to structure a settlement unless their broker is used.[328] In exchange for this business, it has been reported that brokers will often share their commission on annuity purchases for structured settlements with the liability insurer.[329]

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been substantial changes at AIG since. Darer Interview, supra note 227. Therefore, Darer asserts, those utilizing and relying on the memo are "doing their readers a great disservice by implying that the same exists today." Id. Still, there are casualty insurance companies today who strongly push to use affiliate life insurance annuities. Id. But see Ulman E-mail, Feb. 16, 2009, supra note 39 (stating that liability insurers are "often indifferent" to the identity of the life insurer whose annuity contract funds the settlement, assuming that the insurer has strong ratings). However, some argue that this may not be a problem provided that the affiliated company offers a structured annuity with a competitive rate-of-return, has a good balance sheet, and can meet plaintiff's diversification objectives. Darer Interview, supra note 227. Unfortunately, casualty companies sometimes push for the use of an affiliate that does not meet such needs. Id.

325. McBride E-mail, supra note 322 (saying that a lesser quality annuity will "often" be the result); Darer Interview, supra note 227 (stating that the use of an approved list will "sometimes" be problematic).

326. Risk, Structured Settlements, supra note 19, at 879.

327. Id. A class action against Hartford Financial Services Group alleges that Hartford and its approved brokers failed to disclose to claimants that Hartford recaptures brokerage fees by "secretly bundling the broker's four percent (4%) commission into the represented annuity cost. Nor does Hartford reveal that even if a portion of this four percent (4%) 'built-in commission' is not paid to the Approved Broker or In-House Broker, for whatever reason, it is still kept by Hartford for itself." Plaintiff's Class Complaint, supra note 318, at ¶ 44, Doc. 1. Of course, as Hartford argues in its motion to dismiss, plaintiffs do not allege that they received less compensation than promised. Defendant's Motion to Dismiss, 2–3, Doc. 28-3, Spencer, No. 3:05-cv-01681-JCH (Feb. 1, 2006). Their claim, rather, is that Hartford misrepresented the cost of making the promised compensation possible. See id. It has also been reported that claimants are sometimes sent a copy of checks made out to life insurance companies, though a portion of those checks will be refunded. Risk, Structured Settlements, supra note 19, at 888. In addition, the factoring industry has alleged that "illegal kickbacks and rebates [were given by] structured settlement brokers in exchange for directing business to said brokers." 1999 Hearing, supra note 15, at 29 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

328. Grassini E-mail, supra note 322; McBride E-mail, supra note 322.

329. 1999 Hearing, supra note 15, at 29 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

3. Defendants Can Capture Some of the Tax Subsidy

As noted, the greatest advantage of structured settlements for defendants is the ability to pay less.[330] The tax subsidy renders structured settlements more valuable to plaintiffs, perhaps by 20% or more, than their cost to defendants.[331] However, while it is claimant who will directly benefit from their increased value, defendant can indirectly benefit by demanding a decreased settlement payment.[332] Depending on the size of the reduction in defendant's cost, the claimant may reap all, or none, of the tax benefit. While plaintiffs benefit from the exclusion,[333] defendants do as well.[334] Moreover, some observe that defendants leverage their negotiating power, threatening to withdraw the option of a structured settlement in order to benefit from controlling the selection of the structured settlement annuity provider and broker.[335] Thus, the subsidy increases the chance of profiting through the purchase of the annuity, as described in Part IV.A.2.

B. Defendants' and Liability Insurers' Capture May Detract from the Subsidy's Goal

While encouraging the defense to make larger and periodic payments to plaintiffs is consistent with the tax subsidy's purpose, as doing so decreases the likelihood of plaintiffs' later dependence on the government, reducing defendants' damages is likely not consistent.[336]

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330. Andrada, supra note 36, at 471–72.

331. E-mail from William L. Neff, Partner, Hogan & Hartson LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 6, 2009, 11:48:12 EST) (on file with author) [hereinafter Neff E-mail, Feb. 6, 2009] (offering a generally used estimate of savings, stating that "the present value of the stream of tax free earnings is approximately 20% higher . . . than developing the same stream of payments if the earnings were taxable").

332. Some refer to this strategy as the "Section 130 veto." Risk E-mail, supra note 303 (noting that he coined the term "to describe the leverage defendants and their liability insurers traditionally use to coerce claimants into submitting to structured settlements controlled by the tortfeasors or their liability insurers, through intimidation by threatening loss of benefit. If the claimant refuses a structured settlement offer by a defendant or its insurer, seeking to have the claimant's own chosen structured settlement producer handle the transaction, the defendant or its insurer often will then tell the claimant that the entire settlement will be paid as a cash lump sum.").

333. See WOOD, TAXATION OF DAMAGE AWARDS, supra note 306, § 7.24.

334. Risk, Structured Settlements, supra note 19, at 872.

335. Risk, A Case, supra note 7, at 673; see Meligan Interview, supra note 31 (describing how defendants or their casualty insurers will sometimes make one structured settlement offer if plaintiff will agree to using the casualty insurer's life insurance affiliate, and a lower value offer if plaintiff refuses).

336. This is not to suggest that it is in the interest of public policy to increase defendants' payments, merely that decreasing defendants' payments below the value of the harm caused is not, in and of itself, in the interest of public policy.

While this is elaborated upon below, it should also be remembered that any augmentation of plaintiffs' financial ability to cover future needs likely furthers the subsidy's goal.

When considering whether to act in a given way, a logical person will weigh possible advantages and disadvantages. A tortfeasor employer, for example, considering whether to implement costly safety measures, considers the savings and potential damages of that decision. Where the potential damages are slight, such an employer will more readily disregard safety measures.[337] Simply put, "the incentive to take care will be reduced."[338] For this reason, some argue, "Making the defendant pay for the full harm is required [to fully achieve] deterrence."[339] The structured settlement tax subsidy, as shown above, reduces potential damages of tortious actions. One commentator suggests that the structured settlement tax subsidy carries the same effect as "a 'tort reform' measure that simply provide[s] that the federal government would reimburse tort defendants for 20% of their costs . . . structures are not actually used to provide plaintiffs with greater recovery, but to diminish the liability of their injurers."[340] Of course, the reduction in deterrence will impact risk-takers' actions at the margins, and it is impossible to know how much. However, in creating or maintaining a tax subsidy with the effect of reducing deterrence, Congress must be sure that the advantages for public policy outweigh the detriment of reduced deterrence.

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337. See generally Gary T. Schwartz, W. Page Keeton Symposium on Tort Law: Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice, 75 TEX. L. REV. 1801, 1803 (1997) (noting an "explosion of scholarship analyzing tort law in economic terms and emphasizing deterrence as a primary tort objective") (citing FOUNDATIONS OF TORT LAW (Saul Levmore ed., 1994)).

338. Smith, supra note 56, at 1973.

339. Id. at 1973, n.59 (2002) (citing David D. Haddock et al., An Ordinary Economic Rationale for Extraordinary Legal Sanctions, 78 CAL. L. REV. 1, 44–45 (1990)).

340. Scales, supra note 2, at 887. One could also analogize to defendants' ability to obtain the general deduction available for damages paid to plaintiffs. See Blackburn, supra note 61, at 687 ("If a payor is allowed to deduct damages paid, including costs of litigation, then the payor is allowed to spread such costs to the federal government and taxpayers. Furthermore, wrongdoers, just as other taxpayers, factor in the after-tax cost of their actions in shaping their behavior. Allowance of deductions for damage payments in many instances clearly frustrates public policy."). Revenue rulings go even further, allowing the deduction of punitive damages resulting from the ordinary conduct of business. Rev. Rul. 80-211, 1980-2 C.B. 57. Of course, there are exceptions and limitations. See I.R.C. § 162(f) (2006 & Supp. II 2008) (disallowing deductions for fines and government penalties for violating the law); I.R.C. § 162(g) (2006 & Supp. II 2008) (limiting deductibility of certain antitrust judgments and settlements).

Two arguments are made positing that defendants' paying less is not problematic, or at least not overly so. Some argue that it is "logically unnecessary"[341] for defendants to pay exactly what plaintiffs receive because defendants' costs are irrelevant to a compensated plaintiff.[342] However, the argument incorrectly assumes that plaintiffs' monetary compensation is the single driver of personal injury lawsuits.[343] In fact, multiple surveys have found that personal injury claimants are often pursuing non-monetary goals.[344] These include the seeking of an explanation, an apology, public vindication, or the chance to have one's side heard and respected.[345] Anecdotal evidence among personal injury trial attorneys affirms the observation that money is not often claimants' sole objective.[346] The knowledge that a defendant paid for the damage caused may be an end in itself for a plaintiff.

Some commentators also argue that the reduction in defendants' costs can benefit the public at large through reduced insurance premiums. Because liability and casualty insurers pay less, they can charge their clients less.[347] However, this argument ignores the negative impact on deterrence discussed in this section. While lower insurance costs would benefit those paying insurance, it would reduce the disincentive to take risks. The price of insurance is based on the risk of causing harm. Where the tax subsidy decreases the price per unit of risk, some individuals will take on risk that profits them less than it costs society.

Thus, public policy dictates that where possible, and where doing so does not decrease the use of structured settlements, the monetary

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341. Joseph M. Dodge, Taxes and Torts, 77 CORNELL L. REV. 143, 172 (1992) (noting that a personal injury represents the loss of human capital by plaintiff, without a proportionate gain by defendant, such as in a rescission or unjust enrichment case).

342. Derek A. Cave, Structured Settlements: An Alternate Resolution of Claims Involving Death or Substantial Personal Injury, THE ADVOC. 331, 332 (June–July 1979); see Scales, supra note 2, at 888.

343. Scales, supra note 2, at 892.

344. Scales cites multiple sources for this proposition. Id. at 892–93, 893 n.104.

345. Id. at 892–93.

346. E.g., E-mail from Gail K. Johnson, Senior Trial Counsel, Federal Tort Claims Act Section, Department of Justice to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 20, 2009, 13:06:41 EST) (on file with author) (noting that while money "is always in the mix and therefore a motivator . . . [and] remains the typical form of 'apology' and even punishment . . . the importance of it varies").

347. Choulos, supra note 21, at 74; see A Roundtable, supra note 10, at 72 (comments of Herb Cumming); BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, 1997 WL 439544, pt. 2, ¶ 13.1, at *5 (2008).

benefits of structured settlements should be directed to claimants, rather than defendants and their liability insurers.

V.
THE NEXT STEP AWAY FROM THE TWO TAX DOCTRINES: QSFs

In response to the defendant and liability insurer tactics described above, some plaintiffs make use of a tax entity created by Congress in the mid-1980s to facilitate mass tort settlements. Consistent with the public policy perspective discussed in the previous section, the entity, a "qualified settlement fund," or QSF, enables a claimant to capture a greater portion of a structured settlement's benefit, while not discouraging the use of structured settlements.

By utilizing a QSF, a claimant can control the purchase of the annuity for their structured settlement, capturing some or all of the benefits of structuring. Claimants can ask a defendant[348] to pay a lump-sum settlement into the QSF, which acts as a "tax-free way station,"[349] assuming the defendant's liability through novation. The claimant then "negotiates" with a friendly court-appointed QSF administrator to permanently settle his or her claim through a qualified assignment, thereby satisfying the requirements of structured settlement tax subsidy eligibility.

However, where there is only one claimant, that claimant arguably obtains constructive receipt or economic benefit of the settlement monies, under a traditional understanding of the two doctrines.[350] The IRS may soon decide whether the control claimants gain through the use of a single-claimant QSF disqualifies them from eligibility for the structured settlement tax subsidy.[351] The answer is the subject of "a raging debate in the tax world."[352]

This Article argues that the IRS should apply the constructive receipt and economic benefit doctrines as it and Congress have applied the two doctrines before in the context of structured settlements: narrowly or not at all. As we will see, the tax subsidy's purpose remains effective, even in the face of such constructive receipt, and is, in fact, bolstered.

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348. As we will see, claimants can also force defendants to pay an agreed lump-sum into a QSF.

349. Robert W. Wood, Qualified Settlement Funds: A Mechanism Whose Time Has Come, L.A. DAILY J., July 12, 2009, at 6 [hereinafter Wood, A Mechanism].

350. See Part V.B.

351. Infra notes 401–403 and accompanying text.

352. Wood, A Mechanism, supra note 349.

A. QSFs: More Erosion of Tax Doctine

Section 468B of the Tax Code[353] creates a tax entity called a "designated settlement fund,"[354] sometimes referred to as a "qualified settlement fund"[355] or "QSF."[356] Defendants can make an immediately deductible payment into a QSF, which will eventually be paid out to plaintiffs.[357] Thereafter, the fund assumes defendants' liability, replacing a defendant as the party to the suit or agreement for purposes of section 130.[358] Thus, the QSF will be able to structure settlements with the claimant that will be eligible for the ordinary tax subsidy.

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353. I.R.C. § 468B (2006).

354. I.R.C. § 468B(d)(2) (2006).

355. While Congress used "designated settlement fund," I.R.C. § 468B(d)(2) (2006), Treasury used "qualified settlement fund." Treas. Reg. § 1.468B (1992). Likewise, the IRS has called trusts established pursuant to § 468B "QSFs." I.R.S. Priv. Ltr. Rul. 2001-38-006 (May 7, 2001).

356. This Article uses the language of "QSF." However, it notes some of the differences here. The Tax Code provides that a section 468B fund is "any fund . . . (A) which is established pursuant to a court order and which extinguishes completely the taxpayer's tort liability with respect to claims . . . (D) established for the principal purpose of resolving and satisfying present and future claims against the taxpayer (or any related person or formerly related person) arising out of personal injury, death, or property damage." I.R.C. § 468B(d)(2)(A), (D) (2006) (including other requirements). QSFs have less restrictions, and thus more flexibility than DSFs. ROBERT W. WOOD, QUALIFIED SETTLEMENT FUNDS AND SECTION 468B, 1-7, (2009) [hereinafter WOOD, QUALIFIED SETTLEMENT FUNDS]; see id. at 13-13. DSFs, for example, only operate for claims of personal injury, death, or property damage. I.R.C. § 468B(d)(2)(D) (2006). Thus, QSFs are used more frequently than DSFs. WOOD, QUALIFIED SETTLEMENT FUNDS, supra, at 1-8; see id. at 13-3 ("In practice, the QSF has eclipsed the DSF, making it largely irrelevant."); Robert W. Wood, Tax Management Portfolios: Tax Aspects of Settlements and Judgments, 552-3rd, A-75 (BNA) (Oct. 1, 2007) (articulating other differences, which are not necessary to delineate for purposes of this Article).

357. I.R.C. § 468B(a) (2006) ("For purposes of section 461(h), economic performance shall be deemed to occur as qualified payments are made by the taxpayer to a designated settlement fund."). Without this language, deductions could only be made as moneys are received by claimant. I.R.C. § 461(h)(2)(c) (2006 & Supp. II 2008).

358. Rev. Proc. 93-34, 1993-2 C.B. 470; I.R.C. § 130(c)(1) (2006). QSFs cannot be created for worker compensation claims. Treas. Reg. § 1.468B-1(g)(1) (as amended in 2006). The typical sequence of events to use a QSF involves: (1) either side can initiate the use of a QSF by hiring an attorney to prepare the documentation, and an administrator, often the same attorney, (2) that party petitions or moves a trial court, probate court, or government entity to establish a QSF, (3) an order establishing the QSF is entered according to Treas. Reg. § 1.468B-1, (4) a court may be required to approve the settlement, (5) the administrator creates a bank account subject to the court order establishing the QSF and the continuing jurisdiction of that court, (6) the settlement agreement is signed and the money is transferred, (7) defendants are dismissed with prejudice, and finally (8) the QSF and plaintiff establish a settlement with court approval. Qualified Settlement Fund Sequence, http://www.risklawfirm.com/files/QSFSequence10-12-04.pdf (2004).

Enacted in 1986,[359] the QSF grew out of mass tort settlements,[360] and has been used for that purpose.[361] Section 468B was legislated to make settlement payments to a personal injury class immediately deductible for defendants.[362] Though the amount defendant will eventually pay to a plaintiff class may be known, plaintiffs within the class may not yet have allocated the money amongst themselves. Section 468B allows a defendant to make an immediately deductible settlement into a QSF,[363] and extricate itself from the lawsuit via a dismissal with prejudice.[364] Thereafter, the QSF is taxed as a person,[365] and the appointed QSF administrator is in control of distributing the QSF monies.[366] Because a QSF allows the transfer of monies into a fund without the beneficiaries of that fund receiving the income for tax purposes, the authoritative treatise on QSFs describes them as "a simple trust that essentially abrogates the fundamental tax concepts of constructive receipt and economic benefit that go to the root of our federal income tax system."[367]

Under Treasury regulations issued in 1993, a QSF is established pursuant to an order by a court or government entity to satisfy tortious claims,[368] and is subject to that entity's continuing jurisdiction.[369]

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359. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1807(a)(7)(A), 100 Stat. 2085 (1986).

360. Letter from Dewey Ballentine LLP to Gregory F. Jenner, Deputy Assistant Secretary for Tax Policy, Department of Treasury, et al. 1 (Oct. 8, 2003), available at http://www.risklawfirm.com/files/DeweyBallentineltrtoSenBaucus06-29-04.pdf (authored by Stuart Odell, and Joseph K. Dowley, Former Chief Counsel of the U.S. House Committee on Ways & Means (1985–1987), representing The Pension Company) [hereinafter Dewey Ballentine Letter]; see William L. Winslow, Resolving Mass Torts with Designated Settlement Funds, 30 TRIAL 82, 82 (1994) ("special purpose funds primarily grew out of asbestos cases and other toxic tort litigation").

361. Winslow, supra note 360, at 82. In the early 1990s, QSFs were used almost exclusively for large class actions. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-4.

362. See Winslow, supra note 360, at 84.

363. I.R.C. § 468B(a) (2006). The earlier a deduction can be made, the more valuable it is to the taxpayer.

364. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-21. The QSF assumes the defendant's liability through novation. E.g., Order Establishing the Enriquez Settlement Trust and Appointing Administrator, No. 06-CA-242-11-L, i (Fla. Cir. Ct. Seminole Cty. 2008).

365. Treas. Reg. § 1.468B-2(b)(1) (as amended in 1993); WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-6.

366. Though the court has continuing jurisdiction, in most cases, judges rubberstamp distributions. See WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at viii, 2-6.

367. Id. at vii. Where there are many parties arguing over the monies in a QSF, the two doctrines may not be triggered.

368. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006). Other types of claims, such as breach of contract, are also acceptable.

Pursuant to 1993 Treasury procedure, section 130 qualified assignments can be made by QSFs for purposes of structured settlement tax subsidy eligibility because they replace the original defendant as the party to the suit or agreement for purposes of section 130.[370]

B. Capturing More Benefits Through a Single-Claimant[371] QSF

Soon after the Treasury issued the procedure allowing QSFs to produce subsidy-qualifying structured settlements, the most common QSF question became, "How many plaintiffs must participate in the compromise in order to use a designated settlement fund?"[372] Though the defense industry lobbied for section 468B's regulatory framework in the context of mass torts,[373] some plaintiff lawyers and brokers have used the entity for entirely different purposes, sometimes as a "weapon."[374] In order to prevent defendants and their insurers from monopolizing structured settlement negotiations and structured settlement benefits,[375] plaintiff attorneys argue, plaintiffs in single-plaintiff

369. Id.

370. Rev. Proc. 93-34, 1993-2 C.B. 470. See generally I.R.C. § 130(c)(1) (2006). Before 1993, it was believed that QSFs could not use section 130 qualified assignments. Dewey Ballentine Letter, supra note 360, attached memo at 2.

371. Many do not distinguish between single-claimant QSFs and those with several related claimants. Wood, TAX NOTES, supra note 45, at 74; Dewey Ballentine Letter, supra note 360, at 2 n.1 ("For the purposes of this discussion, multiple-claimant situations where settlement amounts between the defendant and each claimant have been determined prior to any payment by the defendant should be considered equivalent to single-claimant situations."); Dewey Ballentine Letter, supra note 360, attached memo at 3 n.7. In truth, it is not clear what constitutes a single-claimant controversy. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 2-40. Thus, plaintiff attorneys are advised to draft complaints with alternative claims, adding other parties when possible. Id.; HINDERT ET AL., supra note 90, § 3.08B[7] (stating that some argue that Medicare and Medicaid liens "constitute separate and additional claims for purposes of 468B funds"). QSFs established with a single injured party and multiple liens or claims are sometimes called "single party" QSFs.

372. Winslow, supra note 360, at 83.

373. NSSTA was the "principal proponent of the issuance of Rev. Proc. 93-34." NSSTA Letter, supra note 14, at 8.

374. E-mail from Michael Russell, Attorney, Garretson Firm Resolution Group, Inc. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 20, 2009, 12:18:52 EST) (on file with author), [hereinafter Russell E-mail] (noting that QSFs are also frequently used as a "weapon" to get a defendant out of the structured settlement process); Darer Interview, supra note 227 (noting that some use QSFs as a "threat during negotiations"). Some plaintiff attorneys will only use the QSF if forced to. Grassini E-mail, supra note 322 (noting the appropriateness of using a QSF where the liability insurer refuses to structure a settlement without using its inadequate list of insurance companies or chosen broker).

375. See Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, slip op., 2006 WL 3455055, at *1 (N.D. Cal. Nov. 29, 2006) (amended order) ("Plaintiffs also seek a court order establishing a qualified settlement trust . . . presum-

settlements can direct the defendants or their liability insurers to pay a lump-sum into a QSF.[376] Thereafter, plaintiffs can discuss how to settle the claim with the QSF administrator in a non-adversarial context,[377] arranging for the purchase of an annuity through their own chosen representatives. Some estimate that between 30% to 40% of structured settlement brokers, or 5% of the industry, use single-claimant QSFs.[378]

While a QSF transfers control over the structuring of a settlement to a plaintiff, a defendant might demand to pay a lower lump-sum, predicting that a plaintiff will benefit from structuring soon after. If

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ably to bypass the DOJ requirements and privately create a structured payment plan."); Meligan Interview, supra note 31 (noting that he may use a QSF to prevent defendant from profiting from the structured settlement, or being involved in planning plaintiff's future). Of course, the use of a QSF must be balanced with its costs. The creation of a QSF is more complicated than a simple structured settlement. Also, their creation will typically cost between $3,000 and $5,000. Darer Interview, supra note 227.

376. Risk, Structured Settlements, supra note 19, at 892 ("plaintiffs can take control of the structured settlement process through a QSF and leave the defense out of the picture once the money has been paid into the fund").

377. Id. at 893; Risk, A Case, supra note 7, at 657 (noting that selection of the QSF administrator is normally subject to claimant approval).

378. Darer Interview, supra note 227. Most life insurance companies will sell annuities to single party QSFs on a case-by-case basis. McBride E-mail, supra note 322; e.g., E-mail from Toni Griffin, Director of Public Relations, MetLife, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 8, 2009, 10:36:02 EST) (on file with author) (discussing MetLife's policy). But see Risk, Structured Settlements, supra note 19, at 895 (noting that very few life insurance companies will sell to single-claimant QSFs). Portions of a 2001 internal memo by John Hancock tax attorneys were published in a 2001 law article, delivering the opinion that the use of a QSF does not constitute constructive receipt "merely because [the claimant] is the single claimant." Risk, Structured Settlements, supra note 19, 896 n.160 (quoting Memorandum from Otto J. Preikszas, Jr. Counsel, John Hancock, to Christi Fried, Director of Structured Settlement (Feb. 24, 2000) (on file with author)). Those companies that do accept single-claimant QSFs on a case-by-case basis typically require a showing of more than one claim. McBride E-mail, supra note 322. However, the true single-claimant case is rare, or even nonexistent. E-mail from John Staunton, Elder Law Attorney and QSF Administrator, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law. (Apr. 20, 2009, 17:25:22 EST) (on file with author) [hereinafter Staunton E-mail]; McBride E-mail, supra note 322. Practitioners observe that there is always some issue that can be "fairly characterized" as an additional claim. Staunton E-mail, supra; see also McBride E-mail, supra note 322 (noting that any case can be characterized as a multiple-claimant case as a result of possible Medicare future interests). These are often Medicaid or Medicare liens, sometimes being "potential claim[s]." Staunton E-mail, supra; see also McBride E-mail, supra note 322; Russell E-mail, supra note 374 (observing that some attorneys use potential claims to constitute multiple claims). Some firms that act as QSF administrators will not accept QSF single party cases unless obligations that could constitute other claimants exist. Id. (noting that his firm will work hard to establish that multiple-claimants exist).

done, plaintiff would be less capable of capturing the benefits of a structured settlement. Once defendants have agreed to a lump-sum settlement payment, however, the use of a QSF, and a structured settlement thereafter, is not necessarily preventable. Though some casualty companies refuse to participate in single-claimant QSFs,[379] courts can and have ordered defendants to pay into a QSF even where not stipulated by a settlement.[380] In addition, plaintiffs can and sometimes do attempt to avoid defendants' knowledge of a QSF's use.[381] There are two steps that plaintiffs can take to guard against defendants learning of a QSF's use:[382] creating the QSF out-of-state,[383] and not directing defendants to pay to a QSF.

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379. HINDERT ET AL., supra note 90, § 3.08B[7]. Liability insurers sometimes oppose the use of QSFs because they wish to benefit from controlling the structuring of a settlement. McBride E-mail, supra note 322.

380. One commentator argues that plaintiffs cannot force defendants to pay into a QSF. HINDERT ET AL., supra note 90, § 3.08B[7] (citing Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, slip op., 2006 WL 3455055 (N.D. Cal. Nov. 29, 2006) (amended order)). Hindert correctly points to Continental Casualty v. United States, where a district court refused to create a QSF because plaintiffs could cite only to regulations, rather than law, empowering the court to do so. Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, 2006 WL 3455055, at *3 (N.D. Cal. Nov. 29, 2006) (amended order) ("As a court of limited jurisdiction this court may not create a qualified settlement account merely because a tax regulation allows the creation of such settlement accounts. Rather, plaintiffs must identify some constitutional or congressional grant of authority providing this court with jurisdiction to create unilaterally qualified settlement accounts."). Thereafter, the court delineated a way that such a QSF could be used with defendant's consent. Id. However, other plaintiffs have persuaded courts to order defendants to pay previously agreed settlement amounts into QSFs. Order Granting Motion for Expedited Relief, No. Civ. 06-1153 MCA/WDS (D.N.M. Jan. 17, 2008). Such courts have, in the past, immunized defendants from liability in the event that funds deposited into a QSF are found to be taxable. E.g., id. at I. It appears that some companies are attempting to prevent such a court order by recommending that their settlements specifically disallow the use of QSFs. Peahl & Miller, supra note 323, at 19 ("The parties agree that the proceeds shall not be payable into a qualified settlement fund ('QSF'), as defined by 26 U.S.C. § 468B or 26 C.F.R. § 1.468B-1(c)(1). No party shall either agree to or seek to obtain a consent or other court order to have any portion of the proceeds placed into a QSF at any time.").

381. Risk E-mail, supra note 303 (stating that he created this tactic and has used it in multiple cases, though declining to describe exactly how).

382. Some in the industry believe that defendants will eventually discover the QSF through the use of a court order. Darer Interview, supra note 227; Neff E-mail, Feb. 6, 2009, supra note 331. However, as the following text shows, this is not necessarily true. Moreover, even if it was, the defendant might not be able to prevent their payment from being entered into and distributed by a QSF anyway. See supra note 381 and accompanying text.

383. The QSF could also be created in the same state, but in a jurisdiction other than where the claim for damages was prosecuted, such as in a probate court that is handling the recovery of damages on the behalf of a minor.

First, plaintiffs can establish a QSF outside of a defendant's purview. Regulations do not require that QSFs be created in the same proceedings, the same court,[384] or even the same state as the tort action.[385] For example, a Florida state court created a QSF for a personal injury action filed in a district court in New Mexico.[386] The Florida court held that its broad authority as a court of general jurisdiction was sufficient to create the QSF.[387] In fact, the only other party Treas. Reg. § 1.468B-1 forces plaintiff to involve is a state entity,[388] which orders and continues to exercise jurisdiction over the fund.[389] This entity could be "the United States, any state . . . territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing."[390] As the treatise on QSFs puts it, "Virtually any federal or state governmental authority willing to do so may order, approve, and take continuing jurisdiction over a QSF."[391] However, QSFs are typically created by courts.[392] By creating the QSF in a faraway jurisdiction, the plaintiff makes it unlikely that the defendant will learn of its existence or use.

Second, plaintiff can direct defendant to pay the lump-sum settlement to a name not typically associated with a QSF. Regulations do not require that defendants' checks be made out to a QSF in order for the monies to be deposited therein.[393] In fact, some courts have created QSFs and ordered that settlement monies paid by defendants to plaintiffs' attorneys be directed into the QSF "regardless of the named

384. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-9, 2-6.

385. See Treas. Reg. § 1.468B-1 (as amended in 2006).

386. See Order Establishing the Nuñez Segregated Account and Appointing Administrator, No. 2007-538, 250, 4 (County Court at Law No. 3 of Lubbock County, Texas, Oct. 31, 2007).

387. Id. (also holding the venue to be "proper"); Order Granting Motion for Expedited Relief, No. Civ. 06-1153 MCA/WDS, Conclusions of Law 4-5 (D.N.M. Jan. 17, 2008) (holding the Texas court to have competent jurisdiction, and ordering defendants to pay into the created QSF).

388. Practitioners note that judges sometimes want the defense to be involved in the creation of a QSF. Russell E-mail, supra note 374.

389. See Treas. Reg. § 1.468B-1 (as amended in 2006). A QSF can be created in a state court while the litigation is in federal court, or by probate, bankruptcy, or administrative-type courts. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 2-6. It can also be created by an arbitration award. Id. 2-7.

390. Treas. Reg. § 1.468B-1 (as amended in 2006).

391. WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-9 (citing Treas. Reg. § 1.468B-1(c)(1)).

392. Id. at 1-11, 2-5.

393. See Treas. Reg. § 1.468B-1 (as amended in 2006).

payee."[394] As courts typically order the establishment of a QSF using a plaintiff's proposed order verbatim it is not likely difficult to secure such language.[395] If the plaintiff can arrange for such a court order, the defendant may never learn of the QSF's existence or use.[396]

C. Ending the Debate Over Single-Claimant Section 468B Funds

The use of single-claimant QSFs is limited by the Treasury's ambiguous position regarding the eligibility of single-claimant QSF payments for the structured settlement subsidy. An increased use of single-claimant QSFs, which would direct structured settlement benefits away from defendants[397] and toward plaintiffs, would likely result from Treasury regulations holding that single-claimant QSFs can make use of structured settlements in the same way as multiple-claimant QSFs. Plaintiffs would therefore likely benefit from regulations formally stating that single-claimant QSF structured settlement payments are eligible for the ordinary structured settlement subsidy. As Part IV.B argued, it is in the interest of public policy to direct the benefits of structuring a settlement away from defendants and their liability insurers, and toward plaintiffs, so long as it does not decrease the number or value of structured settlements. This both maintains the influence of deterrence and augments plaintiffs' ability to cover their future financial needs.

While it is possible to argue that existing statutory, regulatory, and case law implicitly establish this rule, an explicit statement from the Treasury would prevent those considering the use of single-claimant QSFs from abstaining due to ambiguity.[398] The Treasury maintained the issue as an item in its Priority Guidance Plan from 2004

394. Order Establishing the Nuñez Segregated Account and Appointing Administrator, No. 2007-538, 250, d (County Court at Law No. 3 of Lubbock County, Texas, Oct. 31, 2007); Order Establishing the Enriquez Settlement Trust and Appointing Administrator, No. 06-CA-242-11-L, d (Fla. Cir. Ct. Seminole Cty. 2008).

395. McBride E-mail, supra note 322 (noting that courts may involve defendants if they oppose creation of the QSF).

396. No law or regulation prevents the use of such a strategy. Russell E-mail, supra note 374. However, some view the strategy as "not quite legitimate and bad business." Id. The same practitioner does note that it might be a "credible option" where the defendant insists on a lump-sum payment. Id.

397. Even some commentators who disagree that defendants regularly minimize costs via structured settlements believe that the use of a QSF to be "inherently superior to structuring with a defendant." Hindert E-mail, Aug. 17, 2009, supra note 302. In addition, such proponents of QSFs argue that they are better for defendants because they eliminate defendants' "potential future liabilities." Id.

398. Wood, A Mechanism, supra note 349 ("Although the statute itself seems to suggest that even a single-claimant QSF should work, it is best to steer clear of this controversy until it is resolved.").

through 2009.[399] While the issue is not currently in the Plan,[400] it is not likely closed.[401] Throughout this time, proponents and opponents of the rule have made recommendations to the Treasury.[402] Internal disagreement in the government has been reported,[403] and though a 2001 article found the issue "clear and unambiguous,"[404] there is also considerable disagreement in the structured settlement industry.[405] Moreover, it has been reported that some in the insurance industry have urged the Treasury not to issue guidance on the subject at all, so

399. DEPARTMENT OF THE TREASURY, 2008–2009 PRIORITY GUIDANCE PLAN 19 (2008), available at http://www.irs.gov/pub/irs-il/2008-2009pgp.pdf; Third Quarterly Update of the 2003–2004 Priority Guidance Plan, Department of the Treasury 23 (Apr. 23, 2004), available at http://www.irs.gov/pub/irs-utl/2003-2004_pgp.pdf. As of 2008, it was reported that Treasury guidance "will not promptly be forthcoming." HINDERT ET AL., supra note 90, § 3.08B[5] (citing NSSTA Letter to Members (July 23, 2004)). It has been written that the delay "has been due to diversions caused by the need for tax rulings on relief funds for natural disasters such as the recent hurricanes, floods and a tsunami, plus the departure of several key people from Treasury and the IRS." Risk, Attorney Comments, supra note 225. However, the same commentator has received reports "that the issuance of published guidance on the use of QSFs established for the benefit of a single claimant . . . is near." Id.

400. DEPARTMENT OF THE TREASURY, 2008–2009 PRIORITY GUIDANCE PLAN 19 (2008), available at http://www.irs.gov/pub/irs-utl/2009_-_2010_priority_guidance_plan.pdf.

401. See generally Jeremy Babener, Treasury Decides to Pass on Single-Claimant Qualified Settlement Fund Guidance for Now, N.C. L. WKLY., Dec. 14, 2009, at 14.

402. Letter from Skadden, Arps, Slate, Meagher, & Flom LLP to Pamela F. Olson, Assistant Secretary (Tax Policy), Department of Treasury, and B. John Williams, Chief Counsel, IRS, http://www.risklawfirm.com/files/Section130-BasicSkadden Ltrwithatch7-7-03.pdf (June 19, 2003) [hereinafter Skadden Letter] (authored by Fred Goldberg, Former Chief Counsel, IRS (1984–1986), Former Commissioner, IRS (1989–1992), Former Assistant Secretary of the Treasury for Tax Policy (1992), Kenneth Gideon, Former Chief Counsel, IRS (1981–1983), Former Assistant Secretary of the Treasury for Tax Policy (1989–1992), and Jody Brewster, Former Assistant Chief Counsel (Income Tax & Accounting, 1994–1999)); Dewey Ballentine Letter, supra note 360; NSSTA Letter, supra note 14.

403. Risk, A Case, supra note 7, at 645; Risk, Structured Settlements, supra note 19, at 896 n.156; Neff E-mail, Feb. 6, 2009, supra note 331.

404. Risk, Structured Settlements, supra note 19, at 894–95.

405. See Skadden Letter, supra note 402; Dewey Ballentine Letter, supra note 360; NSSTA Letter, supra note 14; ROBERT PEAHL & MICHAEL MILLER, SINGLE-CLAIMANT 468(B) TRUSTS (2007), http://web.aig.com/2007/lit6458/lit6458_AIG468(B)%20Presention_v2.PPT. Robert W. Wood, the author of Qualified Settlement Funds and Section 468B, writes, "The Regulations seem to allow the possibility of a single claimant QSF." WOOD, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 1-26. However, he recommends that the use of single-claimant QSFs be avoided because of the uncertain application of the constructive receipt and economic benefit doctrines. See id. at 2-40. It is unclear if the economic benefit doctrine applies. Id. at 2-54. NSSTA has argued since 1997 that the use of a QSF triggers economic benefit in single-claimant cases. Risk, Structured Settlements, supra note 19, at 896 (citation omitted); id. at 896 n.157.

as to maintain uncertainty.[406] Although the Treasury has not taken a clear position, there is some evidence suggesting that it favors the position of single-claimant QSF proponents.[407]

Those making the case that single-claimant QSFs should not be capable of accessing the structured settlement tax subsidy make four arguments: (1) that the legislation and regulatory structure allowing QSFs was not intended for single-claimant cases, (2) that the use of a single-claimant QSF constitutes economic benefit, (3) that allowing single-claimants to use QSFs will counteract Congress's intention to encourage structured settlements, and (4) that allowing single-claimants to use QSFs will lead to abuses of section 468B. As will be shown, the first two arguments have merit, though are ultimately unpersuasive, while the latter two arguments likely fail outright. As previously discussed, the shifting of structured settlement benefits away from defendants is in the interest of public policy. Thus, the Treasury should issue guidance or regulations holding that single-claimant QSFs can use qualified assignments to structure settlements, accessing the subsidy, in the same manner as multiple-claimant QSFs.

There is significant evidence that section 468B and its regulatory framework were intended for multiple-claimant cases. As noted, section 468B was legislated in the context of mass torts.[408] It appears that the regulatory language that proponents of single-claimant QSFs cite,[409] requiring that section 468B funds be "established to resolve or satisfy one or more contested or uncontested claims,"[410] was issued in response to a mass tort related request.[411] Moreover, NSSTA success-

406. Risk, A Case, supra note 7, at 679–80.

407. The Chief of the IRS Income Tax and Accounting Division, which is the branch assigned the issuance of the relevant regulation, has been cited as confirming "that economic benefit does not automatically occur simply because a QSF is established ultimately for the benefit of a single plaintiff." Risk, Attorney Comments, supra note 225 (citing Jeffery G. Mitchell, Branch Chief, I.R.S. Income Tax & Accounting Division, Address at a seminar sponsored by the Society of Settlement Planners (March 9, 2006)). In addition, the IRS held in a non-binding ruling that moneys transferred into four identical single-beneficiary QSFs would not constitute taxable income to the beneficiaries of the funds. I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997) (entirely ignoring the question of economic benefit).

408. See Winslow, supra note 360, at 84.

409. Risk, Structured Settlements, supra note 19, at 895.

410. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006) (emphasis added).

411. T.D. 8459, 1993-8 I.R.B. 6 (1992) ("One commentator requested that the final regulations clarify whether all potential claims must be asserted before a fund, account, or trust satisfies the requirement of § 1.468B-1(c)(2). In response to this comment, the final regulations clarify that even a single claim satisfies this requirement."). Thus, opponents argue that the "one or more" language is meant to allow a QSF to be created for a single, though soon-to-be joined, member of a plaintiff class. NSSTA Letter, supra note 14, at 9.

fully lobbied for Rev. Proc. 93-34 specifically to use section 130 qualified assignments in mass tort cases.[412] Thus, opponents of single-claimant QSFs argue, use of section 468B for single-claimant cases is misuse.[413]

However, these intent arguments face three substantive deficiencies. First, even if the original intent of section 468B and the accompanying regulatory framework related to mass tort cases, no prohibition exists against existing law applying to evolving practices and purposes.[414] Secondly, the regulatory "one or more"[415] language cited by proponents of single-claimant QSFs[416] suggests that the Treasury was aware that permanently single-claimant QSFs might follow.[417] After all, the first plaintiff of a class, having requested the creation of a QSF, might never be joined by other plaintiffs.[418] And third, though Treasury regulations disallow many particular liabilities from QSF use, such as worker's compensation claims, single-claimant cases are not in that list.[419] Thus, proponents of single-claimant QSFs argue, QSFs with any number of claimants can be created without violating section 468B and its regulatory framework.[420]

Those opposed to single-claimant QSFs argue that the economic benefit doctrine applies and is triggered by single-claimant QSF transfers, necessitating a different tax treatment than for multiple-claimant QSFs.[421] Technically, there is no "express override"[422] of the eco-

412. See id. at 9 ("In the individual tort claimant situation, there was no such need for guidance because the defendant (or its liability carrier) making the section 130 qualified assignment clearly was 'a party to the suit or agreement' under Code 130(c)(1), and hence the claimant in an individual tort situation clearly could avail himself or herself of the section 130 periodic payment mechanism already."); Dewey Ballentine Letter, supra note 360, at 2 ("The sole purpose of Rev. Proc. 93-34 was to permit qualified assignments from section 468B trusts in mass tort situations where a trust is needed to accept defendant's settlement payment and to administer the funds until the individual claims are resolved. . . . Rev. Proc. 93-34 was not written to address situations in which a single claimant is involved."); Dyer Interview, supra note 53.

413. See Dewey Ballentine Letter, supra note 360, at 1–2; NSSTA Letter, supra note 14, at 12.

414. It could be argued that such an action would contradict American notions of democracy; however, the Treasury has discretion to regulate.

415. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006).

416. Risk, Structured Settlements, supra note 19, at 895.

417. Even assuming that the "one or more" language was meant to directly respond to a mass tort related comment request, the explanation stated, "the final regulations clarify that even a single claim satisfies." T.D. 8459, 1993-8 I.R.B. 5.

418. See Risk, A Case, supra note 7, at 659 (providing a hypothetical of a building fire where only one victim is identified).

419. Treas. Reg. § 1.468B-1(g) (as amended in 2006).

420. See, e.g., Risk, Structured Settlements, supra note 19, at 895.

421. Dewey Ballentine Letter, supra note 360, attached memo at 3.

nomic benefit doctrine in the Tax Code or regulations for section 130.[423] In fact, the IRS has applied the economic benefit doctrine test in at least one section 468B trust case.[424] Moreover, the IRS has found the economic benefit doctrine to be triggered where personal injury defendant monies are paid into court ordered trusts for holding and future distribution by a "nonadverse party."[425] Lastly, if a claimant does receive the economic benefit of monies in a QSF, it would be upon the defendant's novation, and prior to any qualified assignment, which may be exempted from the economic benefit doctrine. Thus, opponents of single-claimant QSFs argue, the economic benefit doctrine applies to transfers of defendant monies to QSFs in single-claimant cases.[426]

However, there is substantial reason to doubt that the economic benefit doctrine applies to such transfers. First, with respect to the cases presented in the preceding paragraph, neither involved section 130. The economic benefit doctrine arguably does not apply to section 130(c).[427] The IRS has held that the 1988 amendment[428] to section 130(c) "was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments."[429] Thus, it is argued that Congress did not intend for the doctrine to apply to single-claimant QSFs using section 130 to structured settlements.[430] And, in fact, the IRS has previously held that money transfers into four QSFs, each with a single beneficiary, did not constitute taxable income to the beneficiaries.[431]

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422. Id.

423. Id.

424. I.R.S. Priv. Ltr. Rul. 2001-38-006 (Sept. 21, 2001) (finding that the doctrine of economic benefit was not triggered by the use of a section 468B trust).

425. Rev. Rul. 83-25, 1983-1 C.B. 116. Opponents of single-claimant QSFs also point to an IRS determination that personal injury defendant monies used, pursuant to a court order, to purchase five-year certificates of deposit at a savings and loan association in plaintiff's name, were taxable to plaintiff. Rev. Rul. 76-133, 1976-1 C.B. 34.

426. Dewey Ballentine Letter, supra note 360, attached memo at 3.

427. See Risk, Structured Settlements, supra note 19, at 895.

428. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079, 102 Stat. 3709 (1988).

429. I.R.S. Priv. Ltr. Rul. 97-03-038 (Jan. 1, 1997).

430. See Risk, A Case, supra note 7, at 645 ("Congress did not intend for the judicial doctrine of economic benefit to apply to the facts of a designated settlement fund or qualified settlement fund for the benefit of a single claimant.").

431. I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997) (ignoring entirely the question of economic benefit); Risk, Attorney Comments, supra note 225 ("Obviously, the IRS found that economic benefit did not attach simply because the QSF was established for the benefit of a sole individual.") (citing I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997)); see also I.R.S. Priv. Ltr. Rul. 2001-38-006 (May 7, 2001) (stating that in the

In addition, section 486B of the Treasury regulations states, "Whether a distribution to a claimant is includible in the claimant's gross income is generally determined by reference to the claim in respect of which the distribution is made and as if the distribution were made directly by the transferor."[432] Though this may well have been written to secure excludability of claims covered by section 104(a)(2), the "as if" language could be interpreted to suggest that the economic benefit doctrine should apply to the QSF distribution in the same way it applies to qualified assignments, i.e., it would not apply.[433] Lastly, section 468B Treasury regulations also state that money transfers to QSFs to satisfy a liability are generally not included in gross income.[434] Thus, it seems doubtful that the economic benefit doctrine applies to section 468B claimants structuring their settlements under section 130.[435]

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context of a QSF-related decision, "In order for a taxpayer to include an amount in income under the economic benefit doctrine, the amount must be set aside irrevocably, for the taxpayer's sole benefit, without restrictions or conditions based upon the occurrence of future events."). It is noteworthy that in Private Letter Ruling 2001-38-006, while the IRS cited reasons why the transfer of monies into a QSF with multiple possible beneficiaries would not constitute economic benefit to such beneficiaries, the IRS failed to list the future occurrence of the settlement between the beneficiaries and the QSF as one of the possible "future events." I.R.S. Priv. Ltr. Rul. 2001-38-006. Thus, in the single-claimant QSF scenario, the fact that there must be a settlement between the claimant and QSF might not constitute a "future event" that would prevent the claimant from receiving the economic benefit of monies transferred into the relevant QSF. It is important to recognize that, except pursuant to regulations, private letter rulings cannot be used or cited as precedent. I.R.C. § 6110(k)(3) (2006) (Sept. 21, 2001). However, the Supreme Court has stated that, "although the petitioners are not entitled to rely upon unpublished private letter rulings which were not issued specifically to them, such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws." Hanover Bank v. Comm'r, 396 U.S. 672, 686 (1962) (using a private letter ruling as evidence of a particular interpretation's validity).

432. Treas. Reg. § 1.468B-4 (1992) (emphasis added) (providing, as an example, that if the claim is for a personal injury, it would be excludable under section 104(a)(2)).

433. Nevertheless, opponents argue that even if section 130's economic benefit immunity is extended to section 468B fund distributions, the doctrine is still triggered by the transfer from the defendant to the fund. See NSSTA Letter, supra note 14, at 7 ("The lump sum payment by the defendant has come to rest in the trust in which all of the interests have merged in the claimant and over which the claimant has investment control, before an assignment can ever be made.").

434. Treas. Reg. § 1.468B-2 (as amended in 1993).

435. One could argue that because a single-claimant QSF administrator is a non-adverse party to the claimant, the claimant has control and thus constructive receipt of the monies within a QSF. However, constructive receipt violation arguments face similar deficiencies to economic benefit arguments, see Part III.D. (observing the non-application of the constructive receipt doctrine to structured settlements), though they are not frequently made. Risk, Attorney Comments, supra note 225 ("Constructive

If the economic benefit doctrine is held to apply to single-claimant QSFs, it may be triggered when a defendant transfers a lump-sum payment to a single-claimant QSF.[436] It is argued that monies paid into a single-claimant QSF are no different than a lump-sum payment made directly to claimant.[437] Such arguments highlight the lack of adverse interest or material limitation on the QSF funds.[438]

If the economic benefit doctrine were found to apply, this argument would be persuasive.[439] Though proponents of single-claimant

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receipt has not been raised as an issue in whether a single-claimant QSF can make a qualified assignment."). In addition, while a QSF administrator is a non-adverse party, they are still legally independent of the claimant, having taken a defendant's place through novation. Thus, the claimant does not truly control the QSF monies.

436. Dewey Ballentine Letter, supra note 360, attached memo at 3.

437. NSSTA Letter, supra note 14, at 6.

438. Id. at 6; Dewey Ballentine Letter, supra note 360, at 3. Proponents of single-claimant QSFs argue, "[A]s long as the QSF is established and operated according to Treasury Regulations to 'resolve or satisfy' the claim or claims, there must be a future event (the settlement with the QSF), and that [sic] blocks the claimant from having economic benefit in the QSF's assets." Risk, Attorney Comments, supra note 225. Likewise, they point to a previously cited decision defining the triggering elements for economic benefit; money must be placed in an irrevocable fund beyond the reach of the transferring party, in which the beneficiary has vested rights with receipt conditioned only on the passage of time. Thomas v. United States, 45 F. Supp. 2d 618, 620 (1999) (citing Sproul v. Comm'r, 16 T.C. 244 (1951)), aff'd, 194 F.2d 541 (6th Cir. 1952)). However, a QSF clearly is a fund. It is irrevocable. The question is whether it is beyond the reach of a defendant's or liability insurer's creditors, and whether the beneficiary's interest is vested. Proponents of single-claimant QSFs draft the QSF creation documents with language subjecting the fund to all relevant claims against the defendant, see Risk E-mail, supra note 303 (stating that he does so), and recommend that others do the same. Id. By doing so, it is argued that there is "always a potential that another claimant can surface before the assets of the QSF are distributed." Id. Thus, the QSF monies are within the reach of the transferor's creditors. Id. This argument holds so long as there truly are creditors of the transferor. If not, the contention is not necessarily false, but certainly weakened. As to the claimant's vested right to the QSF monies, the discussion of whether the QSF administrator is an adverse party becomes infinitely relevant. The single-claimant QSF proponents' argument may satisfy the technical language of "vested rights to the money, with receipt conditioned only on the passage of time." Thomas v. United States, 45 F. Supp. 2d 618, 620 (1999) (citation omitted); see Risk, Attorney Comments, supra note 225 ("In a QSF . . . the claimant has absolutely no rights to the QSF's assets until there is an agreement between the QSF and the claimant."). However, other courts may use different language, or look to the function of the QSF and hold the defendant's transfer to give a single claimant such likelihood of receiving the funds that it satisfies the term "vested rights." Id.

439. Cf. Rev. Rul. 83-25, 1983-1 C.B. 116, 117 (finding economic benefit where moneys were ordered to be paid into a trust for holding and future distribution to claimant).

QSFs note the independence of QSF administrators from claimants,[440] the non-adversarial nature must be, and is acknowledged.[441]

The third argument opponents of single-claimant QSFs make[442] is that approval by Treasury would counteract the purpose of the 1982 Periodic Payment Settlements Act:[443] incentivizing structured settlements.[444] Use of QSFs by single-claimants will remove the defense from the structured settlement process.[445] Opponents of single-claimant QSFs assert that the defense's stake in that process promotes the use of structured settlements; "The practical reality born of industry experience is that, as a result [of Treasury approval], fewer physical injury cases will be settled on the basis of a structured settlement."[446] In addition, opponents argue, once defendant moneys are paid into a section 468B fund in a single-claimant case, "history shows that with a lump-sum in hand the temptation is likely to be too great in a significant number of cases, such that recoveries are likely to be prematurely dissipated."[447] Thus, because defendants will decreasingly promote structured settlements, and because single-claimant QSFs will often pay lump-sums to their beneficiaries, it is argued that regulations allowing single-claimant QSFs to access the structured settlement subsidy would thwart Congress's attempt to increase the use of structured settlements.

However, the argument that such regulations would result in fewer structured settlements is unpersuasive.[448] In fact, the use of QSFs may increase the use of structured settlements as a consequence of having additional time to consider structured settlement alterna-

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440. See Risk, A Case, supra note 7, at 661; see also Risk, Structured Settlements, supra note 19, at 895.

441. See Risk, A Case, supra note 7, at 657.

442. NSSTA Letter, supra note 14, at 1 (Approval "would significantly reduce the use of structured settlements to resolve the claims of physically injured claimants, and would thereby undermine the longstanding legislative policy to promote structured settlements.").

443. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605 (1983).

444. See Part II.C–E.

445. Risk, Structured Settlements, supra note 19, at 892; NSSTA Letter, supra note 14, at 4.

446. NSSTA Letter, supra note 14, at 4.

447. Id. at 4–5. QSFs do sometimes pay out lump-sums. Staunton E-mail, supra note 378; Russell E-mail, supra note 374 (noting that QSFs typically involve a structured settlement); Grassini E-mail, supra note 322.

448. Wood, TAX NOTES, supra note 45, at 74 ("Plaintiff brokers and defense brokers alike will still want to sell annuity policies to earn commissions. Whichever type of broker is involved, the broker will surely want an annuity to be purchased.").

tives.[449] Claimants sometimes decline the structured settlement option because they lack the time to understand its complexities, choosing instead the simple form of a lump-sum.[450] The tax subsidy's incentive is not weaker simply because the structuring is done with a QSF rather than a defendant. Secondly, it stands to reason that defendants would still have an incentive to offer a structured settlement option in many single-claimant cases.[451] Defendants or their casualty insurers have access to all of the structured settlement options available to a QSF. Since the creation of a QSF is more costly and complex, a defendant's proposed structured settlement can be more competitive. Third, while defendants may have less incentive to pursue structured settlement negotiations,[452] attorneys specializing in the administration of QSFs would likely encourage the use of single-claimant QSFs. To do so, they would certainly advertise the available tax benefits of structured settlements. Likewise, brokers who profit from selling annuities for structured settlements would also likely promote the option to plaintiffs.

Lastly, opponents of single-claimant QSFs argue that approval of their use would inevitably result in abuse of the section 468B tax entity.[453] It is proffered that tax advisors[454] and single-claimants[455] would attempt to use section 468B funds to improperly defer receipt of income. In doing so, it is argued, some taxpayers will benefit by investing pre-tax dollars.[456] Thus, opponents of single-claimant QSFs assert, Treasury should not allow access to the subsidy.

However, the abuse argument is unpersuasive. Robert W. Wood, author of Taxation of Damage Awards and Settlement Payments, and

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449. Id.; Russell E-mail, supra note 374 (noting the time-factor as the greatest QSF benefit). Contra McBride E-mail, supra note 322 (stating that the use of a QSF does not encourage the use of structured settlements).

450. Wood, TAX NOTES, supra note 45, at 74.

451. Some argue that the danger of lump-sum dissipation is no more present when monies are placed in a QSF than during settlement negotiations with a defendant or liability insurer. McBride E-mail, supra note 322. This is because in both cases the claimant does not have ready access to monies. Id. In both cases, monies will only be transferred upon a settlement agreement. Id.

452. In fact, defendants may encourage the use of structured settlements, even if paying a lump-sum. The defendant could insist on a smaller lump-sum payment by arguing that plaintiff has access to the structured settlement tax subsidy if he or she wishes to use it through a QSF. This would detract, however, from any goal of directing more benefits to plaintiffs.

453. E.g., Dewey Ballentine Letter, supra note 360, attached memo at 5.

454. NSSTA Letter, supra note 14, at 7.

455. Dewey Ballentine Letter, supra note 360, attached memo at 5.

456. It is also argued that approval of single-claimant QSFs could result in deferral opportunities in non-physical cases. Dewey Ballentine Letter, supra note 360, at 3.

the recently released Qualified Settlement Funds and Section 468B,[457] suggests that the dangers of abuse might equally exist for section 468B funds with several claimants.[458] Thus, he argues, the possibility of abuse should not "drive the debate."[459]

Proponents of single-claimant QSFs argue that the defense opposes guidance approving single-claimant QSFs in order to maintain control.[460] Opponents argue that single-claimant QSFs are used to capture annuity commissions for plaintiff brokers.[461] Because the Treasury has failed to issue guidance in response to requests,[462] there is much debate over the tax risk to claimants and their attorneys of using section single-claimant QSFs.[463] It is time for the Treasury to issue guidance specifically providing that single-claimant QSFs can

457. WOOD, TAXATION OF DAMAGE AWARDS, supra note 306.

458. Wood, TAX NOTES, supra note 45, at 74.

459. Id. Depending on the QSF administrator's willingness to delay distribution, the abuse hypothesis could prove to be accurate. However, doing so would have downsides; QSF earnings are taxable at the maximum rate for trusts, I.R.C. § 468B(b)(1) (2006), which is currently 39.6%, I.R.C. § 1(e)(2) (2006).

460. Risk, Structured Settlements, supra note 19, at 892. Through the use of QSFs, defendants would no longer participate in the choosing of annuities for the structured settlement. Risk also argues that the defense would no longer be able to use the tax subsidy as "bargaining leverage." Id., at 893. However, this argument is less persuasive. Defendants who predict or assume that plaintiff will use the QSF to structure a settlement would likely insist on a lowering of their settlement payment. Neff E-mail, Feb. 23, 2009, supra note 32. And, in fact, the possibility of using a QSF is typically introduced early in negotiations. Russell E-mail, supra note 374 (noting that the option of a QSF might not be brought up if the attorneys are not familiar with the entity). It would be possible for plaintiff to capture all of the benefits of a structured settlement, and thus for Risk's argument to bear out, if the defendant never learns of a QSFs use. As discussed in Section V.B., this can and does occur.

461. Wood, TAX NOTES, supra note 45, at 73. In truth, there is likely merit to the observation that commissions are driving much of the single-claimant QSF debate. Id. ("Much of the criticism of the single-claimant QSF, and the abuses to which some argue it is subject, is really hysteria over plaintiffs' brokers thwarting the structure efforts of defense brokers."); Wood, QUALIFIED SETTLEMENT FUNDS, supra note 356, at 2-42; Neff E-mail, Feb. 6, 2009, supra note 331. Some in the industry have observed settlement consultants "abus[ing] the entity to grab the commissions for themselves." Darer Interview, supra note 227. In fact, settlement brokers who typically represent defendants or liability insurers sometimes oppose the use of QSFs because of lost commissions. Russell E-mail, supra note 374. See generally Risk, A Case, supra note 7.

462. See generally id.

463. See Wood, TAX NOTES, supra note 45, at 76; Risk, Structured Settlements, supra note 19, at 901 ("The risk to the plaintiff's attorney, therefore, of a legal malpractice claim brought by his or her client for allowing an adversary to handle the structured settlement for the client seems to be far greater than any tax risk claimed by the opponents of the single-claimant QSF."); Winslow, supra note 360, at 83. Some have asked, if attorneys and brokers who use them are so confident in their interpretation of the tax code and regulations, why are they asking for Treasury guidance on the subject? Darer Interview, supra note 227.

create structured settlements within the constraints of the tax subsidy, in the same fashion as multiple-claimant QSFs.

D. An Acceptable Erosion of Tax Doctrines: One Step Further on the Path

Having recounted and reviewed the available arguments for and against the IRS treating single-claimant QSFs in the same fashion as multiple-claimant QSFs, this Article concludes that doing so is in the best interest of public policy. Far more clearly than factoring, the erosion of tax doctrines for this purpose serves the substantive goal of the legislated structured settlement tax subsidy.

This Article has demonstrated the initial establishment and subsequent deconstruction of the constructive receipt and economic benefit doctrines as applied to structured settlements. At the moment, the IRS faces the next step: whether or not to deem single-claimant QSFs capable of structuring settlements with payments eligible for the tax subsidy. The use of single-claimant QSFs represents yet another level of claimant's control over settlement monies. The claimant essentially accepts the money, and can thereafter decide when and how to use it. This bears resemblance to the revolutionary change in the mid-1990s brought by the factoring transaction. Claimant was given the ability to commit to a structured settlement, but retain the power to sell the future payments at nearly any given time. At first light, it appears that the deconstruction of two tax doctrines violates Congress's original intent, and perhaps more importantly, contravenes the justification of preventing plaintiffs from prematurely dissipating a lump-sum settlement. However, allowing the ability to factor could serve the purpose for which Congress created the structured settlement tax subsidy.

What detractors of factoring fail to observe is that claimants lose the tax subsidy upon the sale of their future periodic payments. While the claimant has benefited from receiving the earnings of their preceding periodic payments tax-free, in deciding whether to factor, they must weigh the need for the upfront money against the incentive of continued subsidy availability.[464] That continued subsidy is obtained only if the claimant acts in conformance with Congress's encouragement, choosing not to factor. Of course, the high discount rates sometimes incurred may reduce the value that the claimant received from the settlement below that which he or she might have obtained by

464. The lump-sum payment from the factoring company is received tax-free. I.R.S. Priv. Ltr. Rul. 1999-36-030 (Sept. 10, 1999). However, as the factoring company cannot exclude the periodic payments as the claimant could, it will not compensate the claimant for that value.

taking a lump-sum to begin with. However, the need for money may outweigh the market price.[465] Congress's concern that a claimant might prematurely dissipate lump-sum settlement monies is only reasonable to the extent that it discourages irresponsible, rather than fast spending. Thus, factoring is not necessarily in direct opposition to Congress's original intent. What is important is that the tax subsidy operates to incentivize the use of structured settlements. Though factoring allows a claimant to sell their future periodic payments, the tax subsidy operates as a continuing incentive not to. Thus, it serves the original purpose of Congress's legislation, while allowing for actions responding to extenuating circumstances. Either way, Congress demonstrated a willingness to bend or break the doctrines of constructive receipt and economic benefit as applied to structured settlements.

Likewise, the single-claimant QSF may violate the relevant tax doctrines, but it maintains, or even bolsters the effectiveness of the tax subsidy. It is true that the transfer of defendant's monies into a single-claimant's QSF gives that claimant substantive control of the money. However, so long as the IRS treats single-claimant QSFs as it does multiple-claimant QSFs, the tax subsidy will incentivize the claimant to create a structured settlement. A claimant can choose not to use one, but he or she could make the same choice during negotiations over a structured settlement with the defendant. In fact, the time provided by the QSF may make the use of a structured settlement more likely. In addition, the use of the QSF may serve to direct a greater percentage of the tax subsidy toward the claimant, rather than the defendant. If true, the incentive to use a structured settlement would be felt more strongly by claimant in a QSF than during plaintiff-defendant negotiations.

Thus, any deconstruction of the constructive receipt and economic benefit doctrines through the use of single-claimant QSFs, when creating structured settlements, does not depart from structured settlement legislative or regulatory history. Moreover, it is consistent with Congress's stated justification for the tax subsidy. In fact, single-claimant QSFs' ability to access the structured settlement subsidy may assist the effectiveness of the subsidy itself.

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465. As noted, some factoring companies charge rates far in excess of the market price. Limitations of such rates, and perhaps increased judicial scrutiny, are likely in the interest of public policy.

CONCLUSION

This Article has demonstrated that though Congress initially established the structured settlement tax subsidy with the constraints of the economic benefit and constructive receipt doctrines, both have been eroded over many years. And, in fact, that erosion may serve the original purpose of the tax incentive: encouraging the use of structured settlements in order to discourage the irresponsible dissipation of lump-sum settlements.

After Congress passed the legislation in 1982, defendants and their liability insurers began capturing a large portion of structured settlement benefits. This works against public policy by decreasing the cost of risk-taking, and by decreasing plaintiffs' incentive to structure, except upon defendants' request. Directing those benefits away from defendants and toward plaintiffs, so long as doing so does not decrease the use of structured settlements, serves the interests of public policy.

The use of single-claimant qualified settlement funds does just that. By shifting control of the structuring of a settlement into plaintiffs' hands, and by providing more time for plaintiffs to decide whether to structure, single-claimant qualified settlement funds make the use of structured settlements more likely. The lengthened time also increases the probability that the structuring of the settlement will accurately schedule future payments to correspond with future needs. Doing so may decrease the likelihood of later factoring, and thus possible premature dissipation.

For these reasons the IRS should issue guidance stating that single-claimant qualified settlement funds are capable of structuring settlements with the resulting periodic payments being eligible for the structured settlement tax subsidy.

triggered in a Code section 130 "qualified assignment" of a periodic payment obligation for a single claimant. Such guidance has never been incorporated in the regulations.]

MS. CRISALLI: I understand.

MR. RISK: Okay, so time may be of the essence, but an additional six months.

MS. CRISALLI: Well, another possibility you might consider is suggesting, when it comes time to make comments on projects for the new business plan, that this be resurrected as a separate project, which would then allow us to propose something if it went out in a reg without delaying the other reg.

MR. RISK: Would it be appropriate to ask why it was terminated or removed from the plan after four and a half years?

MS. CRISALLI: You could ask that, but we won't answer.

MR. RISK: Okay. And I guess my response would be –

MS. CRISALLI: And nobody is supposed to know anything about that. So all these rumors you hear, you know, aren't worth the paper they're not written on.

MR. RISK: Well, it's not on the plan. I guess my immediate reaction was that because of this project, that you were going to include the guidance and that's why it was removed from the "to do" list.

MS. CRISALLI: Okay. Well, obviously that wasn't the case.

MR. RISK: Okay.

MS. CRISALLI: So if you think that this warrants our attention, you might consider, when the notice goes out around April'ish timeframe, soliciting ideas from the public, submitting a letter suggesting that we resurrect it.

Considering the preceding dialog, this request for the resurrection of this issue as a project to be placed on the "2010-2011 Guidance Priority List," is pursuant to the suggestion of Donna Crisalli, Special Counsel, Income Tax and Accounting, IRS.

When this issue was dropped from the Priority Guidance Plan in the fall of 2009, the undersigned proposed on October 1, 2009, that it could easily be resolved by a simple insertion of text into the proposed revision to the Regulations § 1.104. (Attachment 3) This explains my appearance at the February 23, 2010, hearing at the IRS. See my prepared remarks for that hearing (Attachment 4).

I originally called for the issuance of published guidance in my article, *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant,* 23 Va. Tax Rev. 639 (2003-2004). When the editor notified me in April 2004 that the final draft had been set for publication, I immediately emailed a copy of the article to several officials at Treasury and the IRS. A few days later, the topic appeared on the 2004-2005 Priority Guidance Plan. It remained on the "to do"

list until sometime in late 2009, when it was dropped without any public explanation. As Ms. Crisalli so adroitly stated at the February 23, 2010, hearing: "You could ask that, but we won't answer ... And nobody is supposed to know anything about that. So all these rumors you hear, you know, aren't worth the paper they're not written on."

Actually, the first request for published guidance had been made 10 months earlier, on June 19, 2003, by three distinguished alumni of Treasury and the IRS: Fred Goldberg, former Commissioner and Chief Counsel, IRS, and former Assistant Secretary (Tax Policy), Kenneth Gideon, former Chief Counsel, IRS, and former Assistant Secretary (Tax Policy), and Jody Brewster, former Assistant Chief Counsel (Income Tax & Accounting), IRS. (Attachment 6) The request was made on behalf of their client, the Society of Settlement Planners (not identified in the letter), of which the undersigned is a founding member and who has served that organization in various capacities. The Society of Settlement Planners is a national nonprofit educational and public policy association of professional structured settlement producers and others who assist injured claimants in the settlement process.

Jeremy Babener makes a compelling argument in his very recent article in the New York University Journal of Legislation and Public Policy, *Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History.* (Attachment 7) His conclusions are as follows:

> This Article has demonstrated that though Congress initially established the structured settlement tax subsidy with the constraints of the economic benefit and constructive receipt doctrines, both have been eroded over many years. And, in fact, that erosion may serve the original purpose of the tax incentive: encouraging the use of structured settlements in order to discourage the irresponsible dissipation of lump-sum settlements.
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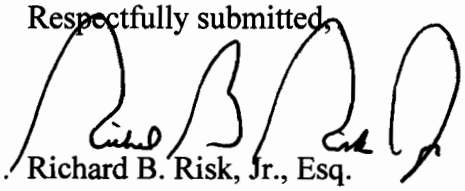
> After Congress passed the legislation in 1982, defendants and their liability insurers began capturing a large portion of structured settlement benefits. This works against public policy by decreasing the cost of risk-taking, and by decreasing plaintiffs' incentive to structure, except upon defendants' request. Directing those benefits away from defendants and toward plaintiffs, so long as doing so does not decrease the use of structured settlements, serves the interests of public policy.
>
> The use of single-claimant qualified settlement funds does just that. By shifting control of the structuring of a settlement into plaintiffs' hands, and by providing more time for plaintiffs to decide whether to structure, single-claimant qualified settlement funds make the use of structured settlements more likely. The lengthened time also increases the probability that the structuring of the settlement will accurately schedule future payments to correspond with future needs. Doing so may decrease the likelihood of later factoring, and thus possible premature dissipation.
>
> For these reasons the IRS should issue guidance stating that single-claimant qualified settlement funds are capable of structuring settlements with the resulting periodic payments being eligible for the structured settlement tax subsidy.

I fully endorse Mr. Babener's conclusion in asking for the issuance of such guidance, with sincere hope that the item does not languish on the Priority Guidance Plan for another four and a half years before being summarily dropped again without explanation.

I submit this request on my own behalf, not on behalf of any organization to which I may be affiliated.

Respectfully submitted,



Richard B. Risk, Jr., Esq.

Enclosures:

1. Office of Tax Policy (Treasury) and Internal Revenue Service 2004-2005 Priority Guidance Plan, July 26, 2004.
2. Unofficial transcript of February 23, 2010, IRS hearing on proposed regulations (REG-127270-06) on damages received on account of personal physical injuries or physical sickness, 2010 TNT 41-15.
3. Submission to the IRS by Richard B. Risk, Jr., October 1, 2009, re: "Proposed Rules DOCID: fr15se09-26, FR Doc E9-22221, 26 CFR Part 1, Para. 2, Sec. 1.104-19(c), compensation for injuries and sickness, published as *Attorney Suggests Changes to Proposed Regs on Exclusion of Physical Injury or Sickness Damages,* 2009 TNT 192-21.
4. Prepared remarks of Richard B. Risk, Jr., pertaining to proposed revision of 26 C.F.R. § 1.104, for delivery on February 23, 2010, before the IRS.
5. Richard B. Risk, Jr., *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant,* 23 Va. Tax Rev. 639 (2003-2004).
6. Ltr, Skadden, Arps, Slate, Meagher & Flom, LLP, June 19, 2003, to Pamela F. Olson, Assistant Secretary (Tax Policy), Department of Treasury, and B. John Williams, Chief Counsel, Internal Revenue Service, Re: Section 130 Qualified Assignments.
7. Jeremy Babener, *Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History*, 13 N.Y.U. J. Legis. & Pub. Policy 1 (2010).

OFFICE OF TAX POLICY
AND
INTERNAL REVENUE SERVICE

2004-2005 PRIORITY GUIDANCE PLAN

July 26, 2004

CONSOLIDATED RETURNS

1. Guidance under section 1502 regarding transactions involving obligations of consolidated group members.

2. Final regulations under section 1502 regarding indebtedness to nonmembers that is traceable to intercompany obligations.

3. Guidance under section 1502 regarding rate or discount subsidy payments.

4. Guidance under section 1502 regarding treatment of member stock.

5. Guidance under section 1502 regarding application of section 108 to members of a consolidated group.

6. Guidance under section 1502 regarding liquidations under section 332 into multiple members.

CORPORATIONS AND THEIR SHAREHOLDERS

1. Guidance regarding redemptions of corporate stock.

2. Guidance regarding transactions involving the transfer or receipt of no net equity value.

3. Guidance regarding selected issues under section 336(e).

4. Final regulations regarding taxable asset acquisitions and dispositions of insurance companies.

5. Guidance regarding the acquisition of businesses having certain nonqualified settlement funds.

6. Guidance under section 355.

7. Final regulations regarding plan issues under section 355(e).

8. Guidance regarding predecessors and successors under section 355(e).

9. Guidance regarding the assumption of liabilities.

10. Final regulations under section 358 regarding allocation of basis.

11. Revision of guidelines for estimating stock basis in reorganizations under section 368(a)(1)(B).

12. Guidance regarding the effect of pre-closing changes of acquiror stock value on continuity of interest.

13. Guidance regarding transfers of assets after putative reorganizations.

14. Guidance regarding statutory mergers.

15. Guidance under section 368(a)(1)(F).

16. Guidance under section 382.

17. Guidance under section 1374.

EMPLOYEE BENEFITS

A. Retirement Benefits

1. Guidance under sections 106 and 401 on retiree health accounts in a profit sharing plan.

2. Guidance on coordination with Puerto Rico law for qualified plans.

3. Procedural guidance with respect to group trusts.

4. Guidance under section 401(a)(4).

5. Guidance under section 401(a)(31) on the default rollover of involuntary distributions.

6. Guidance under section 401(b) on the staggered remedial amendment period.

7. Guidance under sections 401(k), 403(b), 415(c)(3), and 457(b) on post severance elective deferrals.

8. Final regulations under section 401(k) and (m).

9. Guidance under section 402 on the valuation of life insurance distributed from qualified plans.

10. Guidance under section 402A on Roth 401(k) elective contributions.

11. Additional guidance on the Pension Funding Equity Act of 2004.

12. Guidance on the deduction of foreign-sourced dividends by a U.S. subsidiary under section 404(k).

13. Guidance on IRA abuses.

14. Additional guidance relating to the section 409(p) requirements.

15. Guidance on amendments to suspension of benefits provisions.

16. Final regulations under section 411(d)(6) for defined benefit plans.

17. Final regulations under section 411(d)(6)(E).

18. Guidance under section 412 on mortality tables.

19. Proposed regulations under section 415.

20. Guidance on electronic communications.

21. Additional guidance on the relative value of optional forms of benefit.

22. Guidance under sections 457(b) and 501(c)(1) on plans established by federal credit unions.

23. Guidance on ESOPs.

B. Executive Compensation, Health Care and Other Benefits, and Employment Taxes

1. Guidance under section 35 on health care insurance costs of eligible individuals.

2. Guidance on secular trusts.

3. Guidance on the value of term life insurance for split dollar and pension plans.

4. Revenue ruling on tool rental.

5. Guidance under section 79.

6. Revenue ruling on section 83(b) elections.

7. Revenue ruling on timing issues under section 83.

8. Guidance on Health Reimbursement Arrangements (HRAs).

9. Guidance on the election between taxable and nontaxable benefits.

10. Revenue ruling under section 280G on section 83(b) elections.

11. Guidance under section 419.

12. Guidance under section 419A.

13. Guidance on incentive stock options.

14. Guidance on the application of SECA to Conservation Reserve Program payments.

15. Guidance on FICA and FUTA tax with respect to incentive stock options under section 422 and employee stock purchase plans under section 423.

16. Guidance on the employment tax treatment of bonuses paid to employees on the signing of a collectively bargained agreement.

17. Guidance on tips paid to restaurant employees.

18. Final regulations on the student FICA exception.

19. Revenue procedure on the student FICA exception.

20. Guidance on flat rate supplemental wage withholding.

21. Guidance under section 3504.

22. Guidance on withholding for domestic workers.

23. Proposed regulations under sections 4980E and 4980G on employer comparable contributions to HSAs.

24. Final regulations under section 9801.

EXCISE TAXES

1. Final regulations under section 4051 regarding the definition of highway vehicle in sections 145.4051 and 48.4061(a)-1.

2. Guidance under section 4051(a)(2) and (3) regarding suitability for use.

3. Guidance under section 4081 regarding the entry into the United States of taxable fuel.

4. Guidance under section 4221(e) regarding reciprocal privileges.

5. Final regulations under section 4252 regarding toll telephone services.

6. Guidance under section 4261 regarding resellers of air transportation.

7. Guidance under section 4261(e) regarding the exception for segments to or from rural airports.

8. Guidance under section 4291 regarding the duties of the collector of collected excise taxes.

9. Proposed regulations under section 6416(a)(4) regarding claims for gasoline tax.

EXEMPT ORGANIZATIONS

1. Guidance on downpayment assistance organizations.

2. Guidance on low-income housing partnerships and section 501(c)(3) participation.

3. Guidance under sections 501(c)(3) and 4958 on revocation standards.

4. Guidance under section 501(c)(15).

5. Guidance concerning the internet and unrelated business income tax.

6. Regulations under section 529 regarding qualified tuition programs.

FINANCIAL INSTITUTIONS AND PRODUCTS

1. Guidance for RICs and REITs concerning section1(h).

2. Guidance addressing the accrual of interest on nonperforming loans.

3. Final regulations under section 263(g).

4. Final regulations on notional principal contracts.

5. Proposed regulations addressing valuation under section 475.

6. Final regulations under sections 475(e) and (f).

7. Proposed regulations on the flow through of foreign tax credits for regulated investment companies.

8. Guidance on the application to foreign currency gains of the income and asset tests for real estate investment trusts.

9. Guidance on interest-only REMIC regular interests.

10. Regulations on the application of the TEFRA partnership audit procedures to REMICs.

11. Proposed regulations addressing foreign holders of REMIC residual interests.

12. Guidance under section 1256 on the definition of a dealer in securities futures contracts.

13. Guidance on credit card transactions.

14. Regulations regarding accruals for certain REMIC regular interests.

15. Guidance on system upgrade payments made to electric utilities.

16. Proposed regulations under section 7872.

GENERAL TAX ISSUES

1. Proposed regulations under section 21 regarding the credit for household and dependent care expenses.

2. Notice under section 23 regarding the credit for adoption expenses.

3. Guidance under section 32.

4. Proposed regulations under section 41 regarding internal use software.

5. Regulations under section 41 regarding the computation of the research credit in a controlled group.

6. Guidance under section 41 regarding gross receipts for purposes of computing the group credit under section 41(f).
7. Guidance under section 42 regarding the low income housing credit.

8. Guidance under section 42(h) regarding qualified contracts.

9. Guidance under section 44 regarding the disabled access credit for eligible small businesses.

10. Guidance under section 45 regarding state credit offsets.

11. Guidance under section 45D regarding the new markets tax credit.

12. Regulations under sections 46 and 167 relating to normalization.

13. Final regulations under section 59(e) regarding elections.

14. Revenue ruling regarding disaster relief payments to businesses.

15. Guidance regarding the tax treatment of repayments of Commodity Credit Corporation loans.

16. Revenue ruling under sections 61 and 162 on the proper treatment of Medicaid rebates paid by pharmaceutical companies.

17. Guidance regarding the treatment of employee relocation costs.

18. Revenue ruling under sections 121 and 1031 regarding like-kind exchanges of a principal residence.

19. Guidance under section 152 regarding the release of a claim for exemption for a child of divorced or separated parents.

20. Revenue ruling regarding the treatment of payments made by a tax-exempt organization upon its conversion to a taxable entity to satisfy its public-benefit obligations.

21. Final regulations under section 163(d) regarding the qualified dividend income election.

22. Final regulations under section 167 regarding the income forecast method.

23. Final regulations under section 168 relating to like-kind exchanges.

24. Final regulations under sections 168 and 1400L regarding the special depreciation allowance.

25. Guidance under section 168 on asset classes and activity classes under Rev. Proc. 87-56.

26. Final regulations under section 168 regarding changes in classification of property.

27. Guidance under section 170.

28. Guidance under section 172 regarding specified liability losses.

29. Guidance under section 174 regarding the treatment of inventory property.

30. Guidance under section 174 regarding changes in method of accounting.

31. Final regulations under section 179 regarding elections.

32. Guidance under section 469 regarding the limitation on losses and credits relating to passive activities.

33. Final regulations under section 1031 regarding the use of SIC codes in like-kind exchanges of depreciable tangible property.

34. Revenue ruling under section 1241 on the cancellation of lease or distributor agreements.

35. Guidance on corporations chartered under Indian tribal law.

GIFTS, ESTATES AND TRUSTS

1. Update revenue procedures under section 664 containing sample charitable remainder unitrust provisions.

2. Final regulations under section 664 regarding dividends and capital gains for charitable remainder trusts.

3. Guidance under section 664 regarding the partial or complete termination of a charitable remainder unitrust.

4. Final regulations under section 671 regarding the reporting requirements for widely-held fixed investment trusts.

5. Guidance regarding family trust companies.

6. Guidance under section 691 regarding income in respect of a decedent and deferred annuity contracts.

7. Final regulations under section 2032 regarding section 301.9100 relief.
8. Guidance under section 2036 regarding transfers with retained life estates.

9. Guidance under section 2053 regarding post-death events.

10. Guidance under section 2056 regarding qualified terminable interest property.

11. Guidance under section 2518 regarding qualified disclaimers.

12. Final regulations under section 2632 regarding election out of the deemed allocation of the generation-skipping transfer tax exemption.

13. Final regulations under section 2642 regarding qualified severance.

14. Final regulations under section 2651 regarding the predeceased parent rule.

15. Final regulations under section 2702 regarding qualified interests.

16. Guidance under section 2704 regarding the liquidation of an interest.

INSURANCE COMPANIES AND PRODUCTS

1. Final regulations under section 817 on life insurance and annuity contracts.

2. Guidance on the application of the diversification look-through rule under section 817 to tiered investment companies.

3. Guidance on the 2001 CSO mortality tables.

INTERNATIONAL ISSUES

A. Subpart F/Deferral

1. Regulations on the allocation of subpart F income.

2. Regulations under section 959 on previously taxed earnings and profits.

3. Guidance on the PFIC provisions.

B. Inbound Transactions

1. Final regulations on the treatment of portfolio stock in a U.S. insurance branch.

2. Guidance under section 1441.

3. Guidance on securities lending.

4. Guidance on the treatment of certain financial products for withholding purposes.

5. Final regulations under section 1446.

6. Regulations relating to the reporting of bank deposit interest.

C. Outbound Transactions

1. Regulations on the application of section 304 in transactions involving foreign corporations.

2. Regulations relating to the carryover of tax attributes in certain international reorganizations.

3. Regulations on mergers involving foreign corporations.

4. Other guidance on international restructurings.

D. Foreign Tax Credits

1. Regulations on the change of taxable year and foreign tax credits.

2. Regulations on the allocation of foreign taxes.

3. Regulations on the look-through treatment for 10/50 company dividends (see Notice 2003-5).

4. Guidance under section 905(c).

E. Transfer Pricing

1. Regulations on the treatment of cross-border services.

2. Regulations on cost sharing under section 482.

3. Regulations and other guidance on global dealing.

4. Other guidance under section 482.

F. Sourcing and Expense Allocation

1. Guidance on interest expense apportionment.

2. Regulations on the allocation and apportionment of charitable contributions.

3. Regulations and other guidance relating to the treatment of fringe benefits.
4. Guidance on the source of income from the cross-border use of property.

5. Regulations under sections 863(d) and (e).

6. Guidance on interest expense allocable to effectively connected income.

G. Treaties

1. Guidance on reporting and other issues under treaties.

H. Other

1. Regulations and other guidance under section 1(h)(11) on the taxation of dividends from certain foreign corporations received by individuals.

2. Regulations under section 269B.

3. Guidance on cross-border banking and insurance issues.

4. Guidance on possessions issues.

5. Regulations and other guidance concerning the treatment of currency gain or loss.

6. Regulations under section 1503(d).

7. Guidance on cross-border information reporting issues.

PARTNERSHIPS

1. Guidance regarding partnership transactions under section 337(d).

2. Final regulations under section 704(b) regarding the allocation of foreign tax credits.

3. Guidance under section 704(b)(2) regarding whether partnership allocations have substantial economic effect.

4. Final regulations under section 704(c) regarding installment sales.

5. Guidance under section 706(d) regarding the determination of distributive share when a partner's interest changes.

6. Guidance under section 707 regarding disguised sales.

7. Guidance under section 707(c) regarding guaranteed payments.

8. Proposed regulations under section 721 regarding partnership interests issued for services and the treatment of compensatory partnership options.

9. Update of the section 751 regulations.

10. Final regulations under section 752 regarding the assumption of partner liabilities.

11. Guidance under section 752 where a general partner is a disregarded entity.

12. Final regulations regarding the application of section 1045 to certain partnership transactions.

13. Final regulations under section 6031 regarding the reporting requirements of tax-exempt bond partnerships.

14. Final regulations under section 7701 regarding disregarded entities and collection issues.

SUBCHAPTER S

1. Guidance under section 678 regarding trusts that hold shares of a Subchapter S corporation.

2. Guidance under section 1363(d) regarding the treatment of LIFO recapture.

3. Guidance under section 1367 regarding adjustments in basis of indebtedness.

4. Final regulations under section 7701 on deemed corporate entity elections for electing S corporations.

TAX ACCOUNTING

1. Regulations under sections 162 and 263 regarding the deduction and capitalization of expenditures for tangible assets.

2. Regulations under section 263(a) regarding the subsequent treatment of capitalized transaction costs.

3. Update of Rev. Proc. 2004-23 regarding method of accounting changes for intangibles.

4. Revenue ruling regarding the deduction and capitalization of costs incurred by utilities to maintain assets used to generate power.

5. Regulations under section 263A regarding the simplified service cost and simplified production methods.
6. Guidance under section 263A regarding "negative" additional section 263A costs.

7. Guidance regarding the treatment of post-production costs under section 263A.

8. Final regulations under section 263A(f).

9. Regulations under section 381 regarding changes in method of accounting.

10. Revenue procedure under section 446 regarding changes in method of accounting for rotable spare parts.

11. Regulations under section 446 regarding methods of accounting.

12. Final regulations under section 448 regarding nonaccrual of certain amounts by service providers.

13. Revenue ruling under section 461 regarding the proper year for the deduction of payroll taxes on deferred compensation by accrual method taxpayers.

14. Guidance under section 468B regarding the tax treatment of a single-claimant qualified settlement fund.

15. Regulations under section 468B regarding certain escrow funds.

16. Guidance on the tax treatment of vendor allowances.

17. Revenue procedure regarding the valuation of parts inventory by heavy equipment distributors.

18. Guidance regarding the permissibility of a moving average cost method for valuing inventory.

19. Guidance under section 1.472-8 regarding the inventory price index computation (IPIC) method.

TAX ADMINISTRATION

1. Annual compilation of tax shelter listed transactions under section 6011.

2. Proposed regulations under section 6012 regarding the filing requirements for Subchapter T Cooperatives.

3. Guidance regarding information reporting under section 6041 for commissions paid to insurance agents.

4. Final regulations under section 6045(f) regarding the reporting of gross proceeds to attorneys.

5. Revenue procedure under section 6050S regarding changes in method of information reporting by eligible educational institutions for qualified tuition and related expenses.

6. Final regulations under section 6081 regarding the signature requirement to request an extension of time to file information returns.

7. Proposed regulations under section 6103 regarding the disclosure of unrelated third party tax information in tax proceedings.

8. Temporary regulations under section 6103 regarding disclosures to the Department of Commerce.

9. Proposed regulations under section 6103 regarding disclosures to subcontractors.

10. Final regulations authorizing the imposition and collection of reproduction fees for furnishing section 6104 information.

11. Proposed regulations under section 6159 regarding installment agreements.

12. Update of Rev. Ruls. 75-365, 366 and 367 regarding interests in real estate held by a decedent.

13. Guidance under section 6213 regarding math error assessments based on a Form W-2.

14. Revenue ruling regarding the classification of items and the statute of limitations under the TEFRA partnership provisions.

15. Proposed regulations under sections 6320 and 6330 regarding collection due process.

16. Revenue procedure regarding the Collection Appeals Program.

17. Final regulations under section 6334 regarding the seizure of a principal residence.

18. Revenue ruling regarding the limitations on setoff.

19. Revenue ruling regarding setoff with respect to a taxpayer in bankruptcy.

20. Revenue ruling under section 6404 regarding the application of the interest suspension provisions when a taxpayer files an amended return.

21. Revenue ruling under section 6404 regarding the remedies available to taxpayers for violations of the interest suspension rules.

22. Proposed regulations under section 6502 regarding the extension of the statute of limitations on collection.

23. Final regulations under section 6503 regarding the suspension of the period of limitations for noncompliance with a designated summons.

24. Withdrawal of the regulations under former section 6015 regarding the declaration of estimated tax by individuals.

25. Regulations under section 6655 regarding estimated tax payments by corporations.

26. Revenue ruling regarding the definition of "pending" under section 6658.

27. Withdrawal of the regulations under former section 6661 regarding the substantial understatement penalty.

28. Regulations under section 6664 amending the definition of a qualified amended return.

29. Update of Rev. Proc. 94-69 regarding qualified amended returns for CIC taxpayers.

30. Guidance necessary to facilitate electronic tax administration.

31. Revenue ruling under section 7426 regarding refund suits by third parties.

32. Revenue ruling under section 7426 regarding refund claims in lieu of wrongful levy claims.

33. Proposed regulations under section 7430 regarding miscellaneous changes made by TRA 97 and RRA 98.

34. Proposed regulations under section 7477 regarding declaratory judgments relating to gift tax valuations.

35. Proposed regulations under section 7502 regarding the timely mailing/delivery of documents.

36. Final regulations under section 7602 regarding the designation of IRS officers or employees to take summoned testimony or receive summoned information.

37. Revenue procedure regarding the early examination of questionable transactions.

38. Proposed regulations regarding third party and John Doe summonses.

39. Revisions to Circular 230 regarding practice before the IRS.

40. Revenue procedure expanding the prefiling agreement program.

41. Final regulations regarding testimony authorizations and requests for IRS information.

42. Guidance regarding frivolous arguments used by taxpayers in an attempt to avoid or evade tax.

TAX EXEMPT BONDS

1. Final regulations under section 141 on refundings.

2. Proposed regulations under section 141 regarding allocation and accounting provisions.

3. Final regulations under section 143 regarding mortgage insurance fees.

4. Revenue procedure under section 143 regarding average area purchase price.

5. Guidance on LIBOR-based swap transactions.

6. Guidance on arbitrage.

7. Final regulations under section 1397E regarding qualified zone academy bonds.

APPENDIX - Regularly Scheduled Publications

JULY 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in July 2004.

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

AUGUST 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue procedure providing the amounts of unused housing credit carryover allocated to qualified states under section 42(h)(3)(D) for the calendar year.

3. Notice providing the inflation adjustment factor to be used in determining the enhanced oil recovery credit under section 43 for tax years beginning in the calendar year.

4. Notice providing the applicable percentage to be used in determining percentage depleting for marginal properties under section 613A for the calendar year.

5. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the second half of 2004 for use in valuing personal flights on employer-provided aircraft.

6. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in August 2004.

7. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

SEPTEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2004.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period October through December 2004.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in September 2004.

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

6. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal standard mileage amounts.

7. Revenue procedure under section 62 regarding the deduction and deemed substantiation of federal travel per diem amounts.

8. Update of Notice 2002-62 to add approved applicants for designated private delivery service status under section 7502(f). Will be published only if any new applicants are approved.

OCTOBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in October 2004.

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

4. Revenue procedure under section 1 and other sections of the Code regarding the inflation adjusted items for 2005.

5. Revenue procedure providing the loss payment patterns and discount factors for the 2004 accident year to be used for computing unpaid losses under section 846.

6. Revenue procedure providing the salvage discount factors for the 2004 accident year to be used for computing discounted estimated salvage recoverable under section 832.

7. Update of Rev. Proc. 2002-71 listing the tax deadlines that may be extended by the Commissioner under section 7508A in the event of a Presidentially-declared disaster or terrorist attack.

NOVEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the "base period T-Bill rate" as required by section 995(f)(4).

3. Revenue ruling setting forth covered compensation tables for the 2005 calendar year for determining contributions to defined benefit plans and permitted disparity.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in November 2004.

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

6. Update of Rev. Proc. 2002-66 regarding adequate disclosure for purposes of the section 6662 substantial understatement penalty and the section 6694 preparer penalty.

7. News release setting forth cost-of living adjustments effective January 1, 2005, applicable to the dollar limits on benefits under qualified defined benefit pension plans and other provisions affecting certain plans of deferred compensation.

DECEMBER 2004

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 2004.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period January through March 2005.

4. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in December 2004.

5. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

6. Revenue procedure setting forth, pursuant to section 1397E, the maximum face amount of Qualified Zone Academy Bonds that may be issued for each state during 2005.

7. Federal Register notice on Railroad Retirement Tier 2 tax rate.

JANUARY 2005

1. Revenue procedure updating the procedures for issuing private letter rulings, determination letters, and information letters on specific issues under the jurisdiction of the Chief Counsel.

2. Revenue procedure updating the procedures for furnishing technical advice, including technical expedited advice, to certain IRS offices, in the areas under the jurisdiction of the Chief Counsel.

3. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of certain Associates Chief Counsel other than the Associate Chief Counsel (International) on which advance letter rulings or determination letters will not be issued.

4. Revenue procedure updating the previously published list of "no-rule" issues under the jurisdiction of the Associate Chief Counsel (International) on which advance letter rulings or determination letters will not be issued.

5. Revenue procedure updating procedures for furnishing letter rulings, general information letters, etc. in employee plans and exempt organization matters relating to sections of the Code under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.

6. Revenue procedure updating procedures for furnishing technical advice in employee plans and exempt organization matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division.

7. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

8. Revenue ruling setting forth the prevailing state assumed interest rates provided for the determination of reserves under section 807 for contracts issued in 2004 and 2005.

9. Revenue ruling providing the dollar amounts, increased by the 2004 inflation adjustment, for section 1274A.

10. Revenue ruling setting forth the amount that section 7872 permits a taxpayer to lend to a qualified continuing care facility without incurring imputed interest, adjusted for inflation.

11. Revenue procedure providing procedures for limitations on depreciation deductions for owners of passenger automobiles first placed in service during the calendar year; amounts to be included in income by lessees of passenger automobiles first leased during the calendar year; and the maximum allowable value of employer-provided automobiles first made available to employees for personal use in the calendar year.

12. Revenue procedure providing the domestic asset/liability percentages and the domestic investment yield percentages for taxable years beginning after December 31, 2004, for foreign companies conducting insurance business in the U.S.

13. Revenue procedure updating procedures for issuing determination letters on the qualified status of employee plans under sections 401(a), 403(a), 409, and 4975.

14. Revenue procedure updating the user fee program as it pertains to requests for letter rulings, determination letters, etc. in employee plans and exempt organizations matters under the jurisdiction of the Office of the Commissioner, Tax Exempt and Government Entities Division.

15. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in January 2005.

16. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

FEBRUARY 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

3. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in February 2005.

MARCH 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice providing resident population of the states for determining the calendar year state housing credit ceiling under section 42(h), the private activity bond volume cap under section 146, and the qualified public educational facility bond volume cap under section 142(k).

3. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2005.

4. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period April through June 2005.

5. Revenue ruling setting forth the terminal charge and the standard industry fare level (SIFL) cents-per-mile rates for the first half of 2005 for use in valuing personal flights on employer-provided aircraft.

6. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in March 2005.

7. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

8. Notice providing a tentative determination under section 809 of the differential earnings rate for 2004 for use by mutual life insurance companies to compute their income tax liabilities for 2004.

APRIL 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the average annual effective interest rates charged by each Farm Credit Bank District.

3. Notice providing the inflation adjustment factor, nonconventional fuel source credit, and reference price for the calendar year that determines the availability of the credit for producing fuel from a nonconventional source under section 29.

4. Revenue procedure providing a current list of countries and the dates those countries are subject to the section 911(d)(4) waiver and guidance to individuals

who fail to meet the eligibility requirements of section 911(d)(1) because of adverse conditions in a foreign country.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in April 2005.

6. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

MAY 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in May 2005.

3. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

4. Revenue procedure providing guidance for use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio under section 145.

JUNE 2005

1. Revenue ruling setting forth tables of the adjusted applicable federal rates for the current month for purposes of sections 42, 382, 1274, 1288 and 7520.

2. Revenue ruling providing the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period April through June 2005.

3. Revenue ruling under section 6621 regarding the applicable interest rates for overpayments and underpayments of tax for the period July through September 2005.

4. Notice providing the calendar year inflation adjustment factor and reference prices for the renewable electricity production credit under section 45.

5. Notice setting forth the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution for plan years beginning in June 2005.

6. Revenue ruling under section 472 providing the Bureau of Labor Statistics price indexes that department stores may use in valuing inventories.

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DEPARTMENT: Public Comments on Regulations

CITE: *2010 TNT 41-15*

LENGTH: 11528 words

HEADLINE: #15 2010 TNT 41-15 UNOFFICIAL TRANSCRIPT OF IRS HEARING ON EXCLUSION FOR PHYSICAL HARM AWARDS NOW AVAILABLE. (Section 104 -- Damage Awards/Sick Pay) (Release Date: FEBRUARY 23, 2010) (Doc 2010-4501)

CODE: *Section 104* -- Damage Awards/Sick Pay;
Section 468B -- Designated Settlement Funds

ABSTRACT: The unofficial transcript is available of a February 23 IRS hearing on proposed regulations on damages received on account of personal physical injuries or physical sickness; the focus of the hearing was on insurance companies' practices in negotiating settlements with plaintiffs.

SUMMARY: Published by Tax Analysts(R)

The unofficial transcript is available of a February 23 IRS hearing on proposed regulations (REG-127270-06) on damages received on account of personal physical injuries or physical sickness; the focus of the hearing was on insurance companies' practices in negotiating settlements with plaintiffs.

Richard B. Risk Jr. of the Risk Law Firm asked the IRS to use the proposed regs as an opportunity to clarify that *section 468B* qualified settlement funds remain tax free regardless of whether a plaintiff is aware of the amount of the settlement or is the only beneficiary of the fund.

Jack L. Meligan of Settlement Professionals Inc., representing the Society of Settlement Planners, agreed with Risk's comments. The threat of making settlement amounts taxable to the plaintiff under a constructive receipt theory has been used by insurers to discourage the use of qualified settlement funds (QSFs), Meligan said.

John S. Stanton of Hogan & Hartson LLP, representing the National Structured Settlement Trade Association, argued only that the *section 104* regs are not an appropriate place for a revision of the QSF rules.

Speakers also addressed other possible changes to the proposed regulations, including per se exclusions for amounts received for sex abuse or long-term wrongful imprisonment.
Internal Revenue Service

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TEXT:

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UNITED STATES DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE

PUBLIC HEARING ON PROPOSED REGULATIONS
26 CFR PART 301
"DAMAGES RECEIVED ON ACCOUNT OF PERSONAL PHYSICAL INJURIES OR PHYSICAL SICKNESS"
[REG-127270-06]
Washington, D.C.
Tuesday, February 23, 2010

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* * * * *

PROCEEDINGS
(10:00 a.m.)

MR. MONTEMURRO: Good morning, ladies and gentlemen. I'd like to welcome you this morning to this hearing on proposed amendments to the final regulations under *Section 10482* of the code. The proposed amendments would update the final regulations to reflect the changes made by Section 1605 of the Small Business Job Protection Act of 1996. It would also delete the tort type rights test in the current regulations. The reg project number is REG 127270-06.

The next thing I'd like to do is let the panel members introduce themselves, starting at the opposite end of the table.

MS. ROSS: I'm Jeanne Ross, I'm with the Treasury Department.

MS. CRISALLI: Donna Crisalli, with Income Tax and Accounting.

MR. ISKOW: Sheldon Iskow, Income Tax and Accounting.

MR. MONTEMURRO: Mike Montemurro, Income Tax and Accounting. Okay. We have a little bit about -- some of the rules about speaking. We have three scheduled speakers today, but after I'm done with the scheduled speakers, anybody else who wants to speak will have an opportunity to speak, as well. Each speaker gets ten minutes to speak, and there's a little timer here, hopefully you can see it, you get ten minutes. I think the way the lights work is, there's a -- you start with a green light, with three minutes to go, a yellow light comes on, and then the red light comes on, sort of like traffic signals when the time is up.

I will stop the clock if one of the members of the panel has a question for the speaker, and then, you know, and that will stop the clock until that conversation is over, then we'll resume the countdown on the clock, and that's sort of what we'll do, that's the way that sort of works. I've got a beeper on, if you want a beeper on, you want the beeper on, we can figure that out, okay.

So we also have two services here transcribing the hearing, one, the Federal News Service, and one, Tax Analysts, and I think that sort of takes care of all the preliminary matters. What we'll do is, at the end of the three scheduled speakers, other people who want to speak will also have the opportunity to speak, OK. Go ahead, you have a question.

MR. MILLIGAN: I have a question. And I spoke to Mr. Iskow earlier, I had asked for 15 minutes and heard nothing to the contrary, and I've timed my presentation for that, so do I just hand over my script?

MR. MONTEMURRO: Well, I think it's ten -- I think we've said it was ten minutes, so I think that's where we are, you know. It's always a ten-minute presentation, so I think that's sort of what it is.

MR. MILLIGAN: Okay.

MR. MONTEMURRO: So I guess we'll start with the first speaker.

MR. ISKOW: Our first speaker is John McCulloch, representing Integrated Financial Settlements.

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MR. MCCULLOCH: Thank you for letting me appear today. Again, my name is John McCulloch, I work for IFS. We're a large structured settlement brokerage. We provide tax-free periodic payments for plaintiffs and defendants. Every year thousands --

MS. CRISALLI: Can you speak louder because your back is to the audience and they're not --

MR. MCCULLOCH: Do I get time out for that?

MS. CRISALLI: Yes, time out.

MR. MCCULLOCH: Every year we encounter thousands of plaintiffs who we put in tax restructured settlements, but every year we encounter groups of plaintiffs that we are not able to assist because their injuries do not fall under the strict definition of an observable physical harm, a personal physical injury or sickness under 104A2. I'm here today talking about two of those groups, victims of sex abuse and molestation and victims of long-term wrongful imprisonment.

The 1996 Act, which changed 104A2, was never meant to affect these two groups, but because of a lack of clarity, we're really not in a position to help them, and that's what we're seeking here today, is to get some clarity surrounding these two groups of claimants.

When the Small Business Job Protection Act was signed in the law on August 20 of '96, it created -- it imported that requirement that the injuries be physical to be excludable from harm. The conference committee report at 104737 at 301 specified that emotional distress injuries, even those manifesting in a physical injury, were taxable unless they originated in a physical injury or physical sickness. Therefore, the Act elevated being -- an injury being physical to a new level, but neither the Act nor the legislative history went into any detail on how do you define what a personal physical injury or personal physical sickness was.

Throughout the existence of *Section 104*, the taxation of settlements has been interpreted by the Service and the courts to reflect the character of the claim and the damages the recovery is meant to replace or compensate for.

It stands to reason that the Act, which that provision was aimed at employment damages, made those taxable. Since wage loss represents a large component, those recoveries should be taxable. Conversely, an injury settlement to replace a lost limb or the loss of a loved one, those were never items of income, and it stands to reason those are not taxable.

So was congressional intent to exclude certain types of claims or rather that the injury be distinctly physical either in its origin or its result? The conference committee report states that this provision originated in differing views the courts had on employment discrimination -- decision on age discrimination, and the Service's suspension of guidance on the tax treatment of employment discrimination claims. A direct quote from the House bill said that the intent was to change *Section 104A2* so that it did not apply to damages received based on a claim of employment discrimination or injury to reputation accompanied by a claim of emotional distress. So while a line was drawn between physical and emotional injuries, the Act didn't define what types of claims -- what constituted physical injuries.

Nowhere in the bill or the legislative history will you find anything stating a congressional intent to tax sex abuse, molestation, or long-term wrongful imprisonment. We're now 13 years post the Act and we don't have any sort of formal guidance on what constitutes a personal physical injury.

We only have informal guidance in the form of *PLR 2041022*, which gave us the observable harm standard. So to qualify under that PLR for exemption, the injury had to have direct or unwanted or uninvited physical contact resulting in observable bodily harms such as bruises, cuts, swelling and bleeding.

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So while this standard may work for some claims, there's many claims that this standard cannot work for and shouldn't be universally applied. For example, pneumoconiosis is a physical sickness without an observable harm, you can't even see the symptoms until the latter stages of the disease, and yet no one would deny that black lung is a serious physical sickness or illness.

Similarly, tort litigation surrounding some physical sicknesses, such as the cases against Johns-Manville for asbestosis, or the diabetes cases against Eli Lilly from Zyprexa, none of those are observable harms, in fact, the symptoms aren't observable until shortly before death in some cases.

Taken to an extreme, consider a rear end collision with only soft tissue injuries, those harms are not observable, you can't even measure soft tissue injuries under x-ray or MRI, and yet those are consistently considered personal physical injuries.

So if an observable harm is not workable for those, it should not be workable and cannot be workable for sex abuse and wrongful imprisonment claims. For example, a study of 893 sex abused victims reported in the American Journal of Obstetrics and Gynecology, Volume 190, titled Physical Injury After Sexual Assault, was an analysis of urban emergency room sex assault victims. And while bruises and abrasions were the most common injury, they only represented 15 percent. Only seven percent had lacerations. Some 48 percent did not have what could be categorized as an observable trauma. Genital trauma in particular can be very difficult to document even when seen by a physician right away, which is typically not the case in these types of circumstances because of what goes on with the victim, embarrassment, shame, just the overall trauma.

So clearly, you know, we have 48 percent on average of these victims without an observable harm. I would submit to you it is improper to call these purely emotional or nonphysical injuries simply because there's not an observable harm.

The long term effects of both sex abuse, molestation, and wrongful imprisonment are well documented and long lasting. A study in the Journal of Interpersonal Violence, Volume 18, 2003, showed that victims of abuse were four times likely to commit suicide, four times likely to self-mutilate. A study of drug users showed that 42 percent had been abused as children.

A report from the Population Information Program showed that rape and childhood abuse were among the most common causes of post traumatic stress disorder, a disorder which is well understood and well documented in the medical communities, having long term physical and mental effects. Turning to long term wrongful imprisonment, according to the Innocence Project, of the 249 people they've exonerated, the average time spent in prison was 13 years.

Department of Justice study of women's prison showed that virtually every female inmate had been subjected to various levels of sexual aggression, from lewd remarks to rape, while a similar study conducted on men showed the percentage at 22 percent.

The Journal of Epidemiology reports that the long term effects of imprisonment include mental health problems, increased rates of poverty, smoking, poor eating habits, and substance abuse. A 2000 study showed that those in prison exhibited high rates of depression, chronic mental health problems, and substance abuse. The worst outbreaks in recent history from tuberculosis and HIV originated in prison populations.

I think it's without question that there are long term observable effects from both of these types of injuries. These cases were not meant to fall within the scope of the '96 Act. In deference to the very difficult tasks faced by Service and Treasury in attempting to define what is a physical injury, I would submit that for these two specific types of injuries, rather than relying upon an observable harm standard, we create a standard that would fit these cases, that the physical act of abuse or the physical act of deprivation of freedom is in itself a direct manifestation of a physical injury.

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While purely mental or emotional damages are one thing, the act of being deprived of freedom or the act of being abused is, by definition itself, an observable harm.

Turning back to the legislation intent of the Act in '96, Congress did not say that an injury needed to be observable, but what they were trying to do was raise injury claims to a certain threshold, a physical threshold, in order to distinguish it from transitory emotional distress damages, the type of which typically accompany age discrimination or wrongful termination claims.

It is interesting to note that Congress decided that once you reached that threshold, then emotional distress damages became tax free. In the past, we've seen that it's been congressional intent to create tax exemption for wrongful imprisonment with the Civil Liberties Act of 1998. Treasury has ruled in the past, in revenue rulings 56462 and 58370, that victims of -- prisoners of war, that their reparations were tax free, and the Service, in one ruling, post the '96 Act, 199906004, relied upon these rulings to rule that compensation for deprivation of civil rights and freedom was not income. Very distinguishable from short-term wrongful detainment, as we saw in the Stadnyk case, where the detainment only lasted eight hours, and the injuries were no greater than being photographed in a prison jumpsuit.

In terms of the sex abuse cases, the Service itself, a Chief Counsel advisory letter from Mr. Montemurro acknowledged the difficulties found in these cases. In CCA 2009 09001, the Service acknowledged the difficulty in showing an observable harm, the lack of medical records, and acknowledged that absent an observable harm or medical records, that they would assume that an observable harm existed, and it was exempt. And I would submit that all sex abuse cases fall and receive the same type of treatment, no less and no difference from a broken toe or a bruised leg.

Thank you.

MR. MONTEMURRO: I just will make one comment, the thing about --

MR. MCCULLOCH: -- taken your Chief Counsel advisory in vain?

MR. MONTEMURRO: No, that would be observable -- observable harm is a standard. Of course, that was, you know, in the context of one PLR, and you know, sometimes I read a lot that, you know, this is like somehow -- you have to -- in order to get 104A2, you have to be able to observe the harm currently. I would assume that, you know, if somebody were physically injured, were sick, and then they sued later, and the harm had disappeared over that course of time, I would think that that -- that's still a personal physical injury.

I mean I think we were dealing with, you know, a particular factual situation, so to extrapolate that the letter will set some sort of black letter rule, it's just a statement in the --

MR. ISKOW: It's broader.

MR. MONTEMURRO: -- in the, you know, as facts in the letter ruling that we had presented there, that's all I'd say.

MR. MCCULLOCH: Absolutely; the thing we're faced without -- in the field, so to speak, when we're dealing with injury victims, with plaintiff attorneys, with the annuity issuers that provide the structured settlements, they take an extremely conservative view, and while we know PLR's are not presidential, they certainly look at it as to what would the Service do in this situation, and they tend to err on the side of caution. But even if we set the observable harm rule advisory letter aside, it's a gray area. And insurance companies are notoriously conservative.

And, you know, absent a clear definition that sex abuse and molestation is, per se, a physical injury, as we have submitted, or that long term wrongful imprisonment is a physical injury, as we have submitted, there have been err on

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the side of caution and not take these.

And when you look at people who have been abused and people who have been wrongfully incarcerated, those are groups of people who desperately need long term financial planning, they're two groups that are the least capable of doing financial planning, they're dealing with a multitude of mental and emotional issues, the last thing they need is the added burden of trying to, you know, manage bills and invest, things that confound even the best of us.

MR. MONTEMURRO: Thank you.

MS. CRISALLI: I have some questions.

I'm trying to understand exactly what it is you're saying. Now, I assume you're not saying that someone who had a purely mental condition should be able to exclude damages --

MR. MCCULLOCH: No.

MS. CRISALLI: -- because that's not physical, but you seem to be saying that, in certain situations, we should presume that there's physical injury, for example, someone who's suffering from PTSD or somebody who's been wrongly imprisoned; is that what you're saying?

MR. MCCULLOCH: Yes; you know, rather than try and come up with a broad rule, which I would think is impossible, quite frankly, we're looking at two very, very narrow groups. So if you've been molested or abused, even though there's -- there may not be any proof of a physical injury, and, in fact, the statistics show that there is not in most cases, or if you've been in prison for a long duration as opposed to just a short transitory detainment, that those are, per se, physical injuries, with or without an observable harm.

We're not looking for exclusion on any kind of broad basis for non-physical or emotional injuries, it's those two very specific, very narrow groups of people, fortunately very small groups. On average, there's probably several hundred to maybe, at peak, 1,000 people exonerated a year. When you look at a report from the Presbyterian Church, they assume there's about 50 abuse cases annually, which is why I think this has sort of slipped under the radar. These are very small groups of folks; however, we run into them, whether on the plaintiff or the defense side. And it's incredibly difficult to sit across the table from someone whose child has been molested in a daycare and tell them that the life insurance companies that issue the -- annuities won't take this case because they're not sure it's tax free. And we're looking for relief for just those two groups.

MS. CRISALLI: Okay. Is it difficult for plaintiffs, injured people in these groups, to obtain some kind of medical documentation that there is a physical injury that's resulted from this?

MR. MCCULLOCH: Yes.

MS. CRISALLI: Even if it's like high blood pressure?

MR. MCCULLOCH: That wouldn't satisfy the life -- again, the life companies will look --

MS. CRISALLI: Okay. I'm not talking about the life companies, I'm talking about the Service. I mean if the Service said, you know, they would presumably accept it?

MR. MCCULLOCH: The problem, though, is a lot of times people don't seek medical treatment. And in the case of wrongful imprisonment, there is, you know, ultimately not going to be a treating physician for all of the impact for being wrongfully imprisoned. You can seek things later, but tying it back to the wrongful incarceration is not going to

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be successful.

A lot of times, particularly with molestation cases in schools, you'll find an incredibly low rate of physicians treating these folks, and the physicians are not going to just write up something that says you're injured for tax purposes.

MS. CRISALLI: Do you have any indication that these kinds of issues are being raised by the field, by the Service level? You're more concerned about how the insurance companies are adjusting?

MR. MCCULLOCH: We're more concerned about -- in the field, what ultimately leads up to the insurance companies and whether they can accept it. But whether you can do a structure is almost secondary to the issues -- whether these -- are these tax free or are these taxable situations. And often times when you tell a party that it's taxable, it changes the entire dynamic of the settlement negotiation. Do you have to withhold to pay taxes on what your attorneys are being paid? On these cases, if they are taxable, ANT could potentially apply, so the parties have to plan accordingly.

But the problem is not so much being raised in the field offices. Again, I think because these are small numbers of folks, fortunately, I think it would be, in one dimension, terrible if we had, you know, rampant sex abuse cases and wrongful incarceration. But there are a few hundred folks a year, but I don't think that makes it any less important.

MS. CRISALLI: The last question, do you -- can you comment on whether you think we could include a rule like this in a final regulation and be compliant with the Administrative Procedure Act that requires notice and opportunity for public comment?

MR. MCCULLOCH: I believe we could. I think this is an issue --

MS. CRISALLI: Of course you do.

MR. MCCULLOCH: Well, you asked me, and I thought there was sort of a softball, you know, pitch for me to --

MS. CRISALLI: No, it's not, it's a hardball actually.

MR. MCCULLOCH: I do, I think it's an issue that you would find a lot of support on. I don't think administratively or procedurally there would be any objections to including these as, per se, definitions of physical injury, you know, nothing would make me happier than to see that.

MS. CRISALLI: Okay. So we could do it because nobody would care?

MR. MCCULLOCH: No, I think you would do it because you would find that a lot of people care and you would not find objection?

MS. CRISALLI: Nobody would object?

MR. MONTEMURRO: Let me just ask you a question. So you set it at one year, so the guy who is in prison for 11 months, if we say that that's -- if we say that one is a physical injury -- implication going to be that the one 11 months is not a physical injury. Right now no one says that it is or isn't, so that guy is going to be, you know, potentially in a worst position, right?

MR. MCCULLOCH: Potentially, but you have to draw the line somewhere, and it's not an enviable task.

MR. MONTEMURRO: That sort of goes back to Donna's question, that guy with 11 months, he's going to be reading that reg saying, wait a second, I didn't have an opportunity to say get it down to six months, or three months, or two

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months or --

MR. MCCULLOCH: Possibly, but when you look at the -- again, turning back to the data that is available from the Innocence Project, these are not people on death row for 11 months, these are people on death row for over a decade. And I tried to draw the line, as the Service has in other circumstances, capital gains, for example, the difference between short term and long term is a year, it seemed like a good place to draw it.

MR. MONTEMURRO: Congress drew that line, though.

MS. CRISALLI: Well, that kind of gets to my -- well, I said that was my final question, I found another one. Have you talked to them up on the Hill about this?

MR. MCCULLOCH: No, not yet.

MS. CRISALLI: You might think about it.

MR. MCCULLOCH: I will.

MR. MONTEMURRO: Okay.

MS. ROSS: I have a question. I mean you're proposing that we draw the line around the sexual abuse cases and these wrongful termination cases.

MR. MCCULLOCH: Wrongful imprisonment.

MS. ROSS: Wrongful imprisonment, thank you. And I think you said at the beginning of your testimony that it's hard to make the distinction between physical and non-physical, and you think, correct me if I'm mischaracterizing what you're saying, but I think you said that you don't think that distinction can be made and that's why you are proposing to carve out these two groups here; can you say more about why you don't think we could clarify what we mean by physical injury?

MR. MCCULLOCH: Well, in looking back to the employment cases that led to the '96 Act that changed 104A2, you are looking at a lot of emotional distress, mental anguish claims and suits being brought, you know, being incorporated into wrongful termination type suits, and as I look at those, it's hard to know where to draw the line on the emotional distress, mental anguish issue in terms of just overall what you would call non-physical injuries. You know, certainly, if the Service wanted to make non-physical injuries excludable as they were back in the pre-'96 days, you know, that would be beneficial to a lot of folks, but I think you run up against congressional intent, which was to close the door on excludability for employment cases.

So in trying to be consistent with congressional intent and understanding that it is a very difficult task, you know, you would face in trying to carve out or trying to define physical injury, you know, we looked at, you know, one of the two most egregious instances of where we're just unable to help folks, or that there's just big questions of whether they're taxable or tax free.

So that's why we drew the line around these two particular types of cases. These are the sets of taxpayers most in need. You know, I think, looking at what Congress was doing, they wanted to make sure it wasn't transitory, that these injuries rose to a specific threshold so that they weren't just added in to get exclusion from taxation.

And I think with molestation abuse cases and long term wrongful imprisonment cases, you know, these are not people that are adding emotional distress and mental anguish or non-physical elements to get excludability, two very distinct

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groups of folks, you know, and those are the two I'm here arguing for. I mean if we were arguing about excluding all non-physical injuries, I think I would be making very different arguments today.

MR. MONTEMURRO: It has nothing -- in a narrow sense, what you're asking is, these folks who have suffered these injuries, I mean they're not reporting these as taxable income, I'd assume; the question is whether the insurance company will let them structure, rather than take it as a lump sum, whether they can take the money over, you know, 20 or 30 years.

Because I mean I don't know that the Service has ever gone to court on litigation, you know, I know the Service doesn't ever go to court on litigation, anybody who's been falsely imprisoned or anyone who's suffered any sex abuse, as far as asserted in a courtroom that those kinds of damages are taxable, I mean whatever the pure technical answers may be, but I'm saying I don't know that taxpayers are reporting these as taxable damages themselves, it's the matter of whether you go to the insurance company and they'd be willing to structure it, instead of the lump sum payment that comes over time.

MR. MCCULLOCH: That's a hard one to answer. The statistical data isn't there. All that you really have is anecdotal data. For example, the Dallas Star reported when David Pope was freed, you know, they gave him a lump sum, and he actually -- interviewed him, because nine months later he dissipated it all. And the interesting thing, there is a mention in there, almost cursory, about, you know, how it was taxed. It almost is like they were going in the direction of, look, the state with the left hand compensates you for throwing you in jail, and with the right hand, takes it back in the form of taxation, there's an inequity there.

I think the wrongful imprisonment cases are being reported as taxable income; the abuse cases may or may not. I looked, I've done exhaustive research, I could not find the data there.

The Catholic Church and the Presbyterian Church were understandably reluctant to share data about whether they're doing 1099 miscellaneous reporting on these settlements, for example. So, Mr. Montemurro, I tend to agree that they're probably not, but the issue is that these taxpayers shouldn't have to worry. It should not be a roll of the dice whether your settlement is tax free or taxable. You should know if your abuse case or your wrongful imprisonment case is going to be reported and taxed.

MS. ROSS: I just want to make sure I understand what you're saying.

MR. MCCULLOCH: I'm from Chicago, our goal is to dance around the question and talk as fast as possible

MS. ROSS: You're asking for per se rules here. Is your position that they should -- that sexual abuse and wrongful imprisonment cases should come in because they are physical injuries?

MR. MCCULLOCH: Yes.

MS. ROSS: Or that they are non-physical injuries that are at the extreme end of the spectrum, and therefore, should be treated as if they were physical injuries?

MR. MCCULLOCH: I think in the case of wrongful imprisonment, the latter is true. I think in the case of sex abuse, they are -- it's the former. Just because you can't see the impacts of an abuse or a rape doesn't mean it's non-physical.

I think with the wrongful imprisonment, it is -- you're being confined, your civil rights have been deprived, that in itself is a physical act, but when you look at the statistical data from the Journal of Epidemiology, the World Health Organization, lots of long term repercussions that even now are not fully understood, but we know that these folks commit suicide at a high rate, drug abuse, substance abuse, mental health, personality disorders, and I think that is very

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distinguishable from a transitory emotional distress from being fired, or detained in a department store for a few hours because somebody accused you of being a shoplifter or something like that.

I think, as you say, it's on the extreme end of -- and I hate to use the word non-physical, I don't think it's an accurate word, I just think it is a -- rather than having the physical injury itself be physical, the act itself is physical, and a lot of the repercussions and effects are physical.

MR. MONTEMURRO: I mean that's the sort of thing -- do we do a carve-out, because there will be other situations. You could have a stalker, you know, terrorizes somebody, it never touches them, calls them on the phone, takes pictures of their kids, I know where your kids are, and that person could suffer long term, you know, is that physical, never touched them, you know, just called them, but that, you know, I mean there's -- that's always been the problem with this statute. And you've got -- so I don't know whether we want to say, well, we'll treat these two because then other folks will say, wait a second, what about this situation, what about the nine month guy, what about the stalker, what about people who are, you know, falsely -- wrongfully imprisoned, not by the state, but by a kidnapper for three or four days, maybe that happens to a child or an adult --

MR. ISKOW: Hostage.

MR. MONTEMURRO: -- yeah, a hostage, maybe they're released and maybe they were treated well while they were a hostage, but they may be still in terror of their -- of dying or being killed, you know, and you know, well, that person, though, that guy -- his, you know, if we say this one, false imprisonment in a real prison required by state law because you're falsely imprisoned by the state, that's physical, but the guy who may be kidnapped or held hostage for a couple of days by some, you know, kidnapper, well, that guy is, you know, he gets the negative implication.

That's sort of the problem of sort of cutting out two nice little safe harbors, if you want to call it, and then the other folks are still there, and you know, we still may be faced with those as an administrative matter, may accelerate those questions or exacerbate those questions more than we have now.

MR. MCCULLOCH: You know, great points, you know, especially I think this week on -- you had a book about the long term hostages down in Colombia for the three independent contractors, but that's the problem, you know, that the service and Treasury faces, how do you open the door a little bit without throwing the barn doors wide open, which is why we went for these very narrow specific situations, but they tend to be the most frequent.

I mean we do, you know, we are the largest structured settlement, you know, group of brokerage companies, we run into thousands of situations every year, and these are the two that we see that are the most prevalent.

You know, I've been doing this about 15 years, and I've only run into one kidnapping case, but we were, you know, heavily involved in the LA Archdiocese, with some of the Presbyterian Church, we were involved with some of the folks wrongfully incarcerated in Texas, trying to set up taxable periodic payments.

You know, I think those other situations are more one -- and I think can, you know, be addressed by informal calls for guidance, for example, to the field or national office, even private letter rulings. But I think that there's a sufficient number of abuse molestation victims and wrongful incarceration victims that it warrants these two separate -- if you will.

MR. MONTEMURRO: Okay, very good. Thank you.

MR. MCCULLOCH: Thank you.

MR ISKOW: Our second speaker is Richard Risk, who is representing himself.

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MR. RISK: Thank you. And as I -- before the clock starts, as I mentioned here, I had prepared comments for about 15 minutes, and I'm going to skip through a lot of this, and so if the -- is not correct, it's because I left out large blocks of what I had prepared to say, unless the Chair would grant the extra five minutes. Can't do?

MR. MONTEMURRO: No, I can't.

MR. RISK: Okay.

MR. MONTEMURRO: Everybody, you know, that was the, you know, the public announcement was ten, so --

MR. RISK: All right. Well, ladies and gentlemen, Mr. Chairman, thank you very much for the opportunity to appear. My name is Richard B. Risk, Jr., I reside in Tulsa, Oklahoma and St. Petersburg, Florida. I'm an attorney whose entire law practice focuses on the aspects of tort claim settlements. I've written documents to establish more than 250 qualified settlements funds and have administered the majority of them. I've been published extensively in legal journals and have chaired tax panels for professional associations, the Society of Settlement Planners, including guest panelists from Treasury and the Internal Revenue Service. I'm appearing today on my own.

Structured settlements are a very important tool in the resolution of satisfaction of claims originally asserted by injury victims against the tort -- after the liability for such claims has been transferred by novation to the qualified settlement fund. I'll get to the tax issues in a few minutes, but first I want to present a little background of the undercurrent within the structured settlement industry that may serve to explain why we may have differences of opinion among ourselves as to how the tax codes should be interpreted.

I first came into the structured settlement community in 1986 as a producer, and eventually joined the National Structured Settlements Trade Association because it was required of anyone who sought to be appointed by the major annuity markets. At the time I joined the Trade Association, the marketing orientation for structured settlements was almost entire from the defense side. Structured settlement producers worked with corporate risk managers and liability insurance claim adjustors to propose periodic payments to injury victims, along with the attractive tax subsidy, as a way the responsible party could save money and settle claims.

If a claimant or claimant's attorney wanted to know the cost of the funding asset, the annuity, the response was that knowledge of the amount that caused the claimant to be in constructive receipt of the funding asset, and thus would lose the tax benefits.

If the claimant felt uncomfortable, allowing the structured settlement producer engaged by the defendant to handle perhaps the biggest financial transaction of their life, and wanted to engage or consult with a fiduciary duty to the claimant, the response was, take the structure that we offer or take cash.

These were hardball tactics designed to keep control of the structured settlement process for the defendants and their insurers. Loss of control meant loss of money saving tool -- of the money saving tool for the defense, and in some cases it also meant the loss of profitable annuity business for insurance groups that had life insurance affiliates, because the liability insurer could control where significant amount of settlement dollars were spent. The National Association of Insurance Commissioners calls this practice steering and describes it as an inappropriate solicitation activity.

Loss of control of the structured settlement transaction also meant the loss of sales commissions paid by the life insurance companies to life insurance agents who like to call themselves brokers as a reward for their efforts on behalf of the defendants or the insurers.

When one thinks about it, the refusal by the defense to allow an injury victim the right to engage his or her own

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structured settlement specialist to handle the periodic payment arrangement is morally indefensible. After all, the claimant is the ultimate consumer of the annuity even though the tax considerations prevent actual ownership.

By the mid 1990's, the defense canard that knowledge of an annuities cost causes constructive receipt have been revealed to the plaintiff's bar is untrue, and the amount of the proposed annuity premium to be spent by the defense then became integral to the settlement negotiations. The mediation paradigm had shifted from, "we offer you a cash lump sum and periodic payments as described in this proposal", to "let's settle on the total cost to the defense of settlement and then we'll decide how much will be spent on periodic payments."

With that paradigm shift, the commission for the annuity sale, which was bundled into the annuity premium, was now part of the gross settlement amount offered by the defense. Then the issue became which side had the right to pay a structured settlement specialist using the built-in commission.

Claimants began to assert that commission was part of the settlement offer, and therefore, they were entitled to engage the services of a structured settlement specialist loyal to them and to use the commission as compensation.

This notion upset the structured settlement agencies when they were in total control of structured settlements, and the battle over who gets the commission still rages today. The National Structured Settlements Trade Association, or NSSTA, fears the use of the qualified settlement fund because it gives the plaintiffs the opportunity of the structure without involvement of the defense. As early as 1997, NSSTA began to discourage the use of the CSF except in mass torts. It turned to its text counsel, the law firm of Hogan and Hartson, who came up with the theory that a qualified settlement fund created for a single claimant resulted in that claimant having the economic benefit and the funds.

In more than one instance, Hogan and Hartson claims that some officials at the Service, in this building, agree with their theory of economic benefit attaching when there is a single claimant. And details of that effort appear in my Virginia tax review article which is cited in my written comments, and I do have a hard copy of that that I can provide for the record, beginning at page 673.

So the economic benefit theory promulgated by the defense is the new canard to replace the old one. Remember, knowledge of the cost of the annuity is constructive receipt.

Well, the irony here is that NSSTA's stated mission is to promote the use of structured settlement, but in this case it was looking for a way to stop them from being arranged without the defense participation. They were, and still are, in effect, discouraging the use of structured settlements rather than promoting them. As soon as NSSTA discovered the request to Treasury in June of 2003, submitted by three distinguished alumni of the Internal Revenue Service, the request for published guidance on the single claimant issue, NSSTA wrote a letter urging that the guidance not be published. They did not advance any liable tax theory as to why a single claimant should be deemed or have economic benefit. They simply didn't want the guidance to be published, and that seems to be their mantra, just don't publish the guidance.

I note that John Stanton of Hogan and Hartson has submitted written comments for this hearing and is scheduled to appear right after me on behalf of NSSTA, and I believe he has submitted the 2003 NSSTA letter for the record of these proceedings. This is simply another way of saying don't publish the guidance.

His stated purpose, I understand, of being here today is to refute my suggestion, that the economic benefit issue be resolved -- can be resolved easily in the proposed revision, *Section 1.104 of the regulations,* on the basis that my suggestion exceeds the scope of the proposed revision. Of course, the scope should be whatever is needful, using a word from the statute, in order to clarify Code *Section 104.* I suppose I should be flattered that NSSTA used me as a threat to disrupting the status quo, and I hope that speaks for the credibility of my remarks today.

Now, let's get to the tax issues. I understand that branch four has limited the scope of the proposed revision to a couple

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issues in order to avoid the type of controversy that has stalled this project in the past. But the scope of this project should be determined by the necessity for guidance related to the tax code, *Section 104*, and not limited for the convenience of staff.

This issue is primarily a Code *Section 104* issue, and the corresponding regulation is an appropriate place to clarify how the code will be interpreted. I sincerely hope you'll recognize the legitimate need to clarify and that the law requires such clarification, and I refer to *Section 7805D* of the code.

There's simply a duty to the taxpayer constituency, a statutory duty of that to provide the guidance. This need is compounded by the fact that certain people within this building reportedly have made comments being used by the defense community to promote fear among those who would otherwise employ the qualified settlement fund for the benefit of their clients. I'm not asking the Service to develop a new policy to clarify this issue. I submit that the policy is already in existence, except that one must go to several different sources to piece it together.

The proposed scope of the regulation, of the revision rather is to incorporate some legislative history dating back to 1996, that's 14 years ago. What about the legislative history from 1982 that never got included in the regulations? That's 28 years ago, twice as long.

I elaborated in my earlier written submission on the policy that already exists, and I won't repeat it here for the record.

So I urge this panel to consider the writings of Jeremy Babner, who submitted his article on the single claimant issue for the record. The point here is that all these events I've described above and in detail in my previous submission, as well as in my Virginia tax review article, demonstrate that Congress, Treasury, including the IRS, and the courts have spoken on the single claimant issue, confirming that economic benefit does not attach in periodic payment arrangements. The rule is still from all of these events to be appropriately inserted into the corresponding regulations for Code *Section 104*. I previously provided proposed text, one single paragraph, for your consideration. Is that it? That's it, okay. All I can say is, please don't forget, you're here to serve the people, not the other way around. Thank you.

MR. MONTEMURRO: Very good.

MS. CRISALLI: I have a couple questions. If the defendants have so much leverage that they can say, take this structured settlement or you get a lump sum, why don't they have leverage to say if you don't use a QSF, we offer X, but if you use a QSF, it's X minus Y?

MR. RISK: I've heard that, I've heard that that's employed.

MS. CRISALLI: So in that case, you know, if the plaintiff has enough leverage to counter that, wouldn't they have enough leverage to counter without using a QSF?

MR. RISK: I'm not quite sure I'm following you, and maybe I'm not the right person to try to answer that.

MS. CRISALLI: Well, you're suggesting that without a QSF, the defendant can impose its will in terms of the settlement --

MR. RISK: That's true.

MS. CRISALLI: -- and I'm saying that even with a QSF, if the defendant had that much -- I'm asking, I'm suggesting, I don't know, if the defendant had that much power, perhaps they could also --

MR. RISK: I used to be in that position.

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MS. CRISALLI: -- undermine the use of a QSF?

MR. RISK: I used to be in that position. I would show up at mediations, and the defense person would literally scoff at me and say why are you here, this is my case, I am representing insurance company X, this is my case, you're going to go home with nothing, and at some point in the span of time, it was figured out that we could use the qualified settlement fund to replace that defendant. After all, the only thing the insurance company really should want is the release and the dismissal from the action, and so they could get that, they could get your tax deduction by the QSF, and that's an incentive.

And the courts will recognize this, too. The courts will recognize that if you create a qualified settlement fund and say to the court this is simply an entity to receive the settlement proceeds and give the plaintiffs then the time to make some informed financial decisions that they would otherwise be pressured into making at the time of the mediation. The defendant is out of the picture, and it would be a beneficial interest if they still wanted to impose their will and direct where the annuity goes. So I'm not sure that the carrot on the stick, so to speak, will give you a higher amount. I haven't really used it -- heard it used in that context, I've heard it used in -- you need to structure, and if you structure with us, we'll give you so much money, and if you don't structure, it'll be a cash lump sum of a lesser amount, which seems to suggest that there is a profit motive for the defendant.

MS. CRISALLI: Let me ask you the question I asked the last speaker, although I'll rephrase it. How do you think we could include a rule like this in a final reg under the APA without having proposed it first, a rule such as you suggest in your written comments?

MR. RISK: I'm not sure, I mean I don't understand the workings of the process as well as you do, but I assume that there's an opportunity for you to restate your proposal.

MS. CRISALLI: Well, we could repropose, yes, and then that would delay the effectiveness of the other rules that we have in there.

MR. RISK: Excuse me, but we're now 14 years into this.

MS. CRISALLI: Well, I understand.

MR. RISK: And maybe 28 years.

MS. CRISALLI: I understand.

MR. RISK: Okay. So time may be of the essence, but an additional six months.

MS. CRISALLI: Well, another possibility you might consider is suggesting, when it comes time to make comments on projects for the new business plan, that this be resurrected as a separate project, which would then allow us to propose something if it went out in a reg without delaying the other reg.

MR. RISK: Would it be appropriate to ask why it was terminated or removed from the plan after four and a half years?

MS. CRISALLI: You could ask that, but we won't answer.

MR. RISK: Okay. And I guess my response would be --

MS. CRISALLI: And nobody is supposed to know anything about that. So all these rumors you hear, you know, aren't

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worth the paper they're not written on.

MR. RISK: Well, it's not on the plan. I guess my immediate reaction was that because of this project, that you were going to include the guidance and that's why it was removed from the "to do" list.

MS. CRISALLI: Okay. Well, obviously that wasn't the case.

MR. RISK: Okay.

MS. CRISALLI: So if you think that this warrants our attention, you might consider, when the notice goes out around April'ish timeframe, soliciting ideas from the public, submitting a letter suggesting that we resurrect it.

MR. RISK: Would the same consideration then apply, because there's some darn good recommendations here regarding the definition of physical injury --

MS. CRISALLI: Absolutely.

MR. RISK: -- and that's beyond the scope of your proposal.

MS. CRISALLI: Absolutely.

MR. RISK: So I guess what -- if I understand you correctly that -- you're saying we're going to go ahead with the proposal that we've made and then it would be a whole new ballgame then if we considered other things?

MS. CRISALLI: I'm not saying anything.

MR. RISK: Okay.

MS. CRISALLI: But I am saying that one possibility would be to finalize the reg without these new proposals and address them in a separate guidance project rather than hold everything up to repropose. In other words, there's no reason why your proposal or the proposal without defining physical injury has to be attached to this project; it could be a separate project.

MR. RISK: Okay. I would agree with that. I have a little familiarity with the way the bureaucracy works. I was in the -- I was an Air Force officer, a squadron commander and a staff officer and a general's aide for several years, and I also ran a federal agency, and I do know that there are sensitivities of stepping into somebody else's bailiwick and whatever, and I thought that maybe because this had been at Treasury for four and a half years, that maybe it was untouchable.

MS. CRISALLI: I don't think that there is any -- that it would be any easier to get us to revisit this issue by attaching it to this project than by creating a new project. I don't, you know, the issue is going to be what are the other priorities on the business plan, do we have the resources, you know, is this of significant importance or more important than other projects that are vying for attention, and that would be the case whether we repropose these regs and wrap it into that or do another project. So you have to convince us that this is of more importance than other projects, that's the key.

MR. RISK: I've done my very best.

MR. MONTEMURRO: I guess we're done.

MS. CRISALLI: Thank you.

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MR. MONTEMURRO: The next speaker.

MR. ISKOW: The next speaker is John Stanton of the National Structured Settlements Trade Association.

MR. STANTON: Good morning. I'm John Stanton, I'm a partner with the Washington law firm of Hogan and Hartson. I represent the National Structured Settlement Trade Association and I'm here to continue the discussion about the dogs that didn't bark, but --

MR. MONTEMURRO: Maybe raise your voice a bit, a little louder.

MR. STANTON: On behalf of the Association, we would like a chance to respond. Some structured settlements have been invoked here. By way of background, the National Structured Settlement Trade Association, NSSTA, is the trade association of the structured settlement industry. It represents the entire industry, ranging from the plaintiff and defense brokers who work with the parties at the settlement table to develop, negotiate and implement the structured settlement, the life insurance companies who, under the congressional tax rules, create structured settlements, fund the structured settlements by way of annuities, the casualty companies that use structured settlements, participate in structured settlements to resolve their liability claims, plaintiff attorneys, defense attorneys, those that are active in the field.

You've got some important issues to address in this project, but our view is that structured settlements is not one of them. As you know, the project does not address structured settlements, and we see no reason to do so.

The suggestion has been made that the project be used as an opportunity to address this issue of a trust report to be created under *Section 468B* to -- for the benefit of a -- claim entered to a structured settlement. That issue is not addressed in the proposed regulations, it's beyond the scope of the proposed regulations, and we see no reason to address that issue by way of the vehicle of the project before you particularly since, as was noted, the guidance project regarding the single claimant, 468B, was dropped from the priority guidance plan.

Let me just say by way of background that structured settlements have been around for about 30 years and they work quite well. The structured settlement tax rules that were adopted by Congress in 1982 lay out a bright line path that's been followed in hundreds of thousands of structured settlements by claimants.

Structured settlements in which both sides today are represented by their own brokers, their own lawyers. Structured settlements enjoy broad support among the plaintiffs, by the defense, by the claims community, judges, mediators, the federal government.

The federal government engages in structured settlements quite lively to resolve federal -- cases, vaccine compensation cases, military hospitals. We see no reason to use the vehicle -- the project before you to reopen the structured settlement tax rules that have worked quite well over time. So, with that, I'd be pleased to answer any questions that you may have. I appreciate the opportunity to appear today.

MS. CRISALLI: Nope.

MR. MONTEMURRO: Okay, very good.

MR. STANTON: Thank you.

MR. ISKOW: Thank you.

MR. MONTEMURRO: That completes the list of scheduled speakers. So I'm just going to open up the floor. If anybody else wants to speak, raise your hand and come on down, introduce yourself and whether you're speaking on behalf of

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yourself or an organization. You had your hand up first, so you go first.

MR. MILLIGAN: Thank you for this opportunity to be heard. My name is Jack Milligan, I live in Portland, Oregon, I am a cofounder and co-President of Settlement Professionals, Incorporated, a 23 office nationwide firm that specializes in settlement planning directly with and on behalf of the personal injury victim.

I have been actively involved in the structured settlement and settlement planning industry for 25 years. I am a founder of the Society of Settlement Planners, SSP, and served as that organization's first president for its first three years.

I am a former member of NSSTA, the National Structured Settlement Trade Association. The SSP's members take an oath of loyalty to personal injury claimants and devote 100 percent of their practices and efforts to assisting these unfortunate victims to plan their settlements and their entire financial futures. The SSP is a professional trade association as opposed to being an industry trade association. The SSP does not have voting membership categories for annuity life insurance companies, for casualty insurance companies, for personal injury plaintiff or defense attorneys, or claim adjustors. Only our professional practitioner members are allowed to vote or hold office.

The SSP Mission Statement is to promote and preserve the rights of personal injury claimants to choose their advisors and product providers as they plan their personal injury settlements.

I am here today representing the SSP, in support of the effort to make the much-needed changes to *Section 104A*, as expressed by Mr. McCulloch in his comments, and also by Mr. Higgins in his written comments to this panel, and to support Attorney Richard Risk's suggestion that this effort include simple language that will positively assure personal injury victims that the doctrine of economic benefit will not apply to a qualified assignment emanating from a single claimant, QSF. I am also here to refute certain statements made by Mr. Joseph Ricci, the Executive Director of NSSTA, in his letter to this panel, and also just now by Mr. Stanton. In his letter, and in Mr. Stanton's comments, both assert that the insurance industry organization, NSSTA, represents all professionals in the structured settlements industry, both defense and plaintiff, and that all are opposed to Mr. Risk's suggestion, this is -- false.

NSSTA does not represent me, nor the merely 50 members of the SSP which includes both financial as well as legal settlement planners from around the country, all of whom have a stake in *Section 104* on a daily basis, and all of whom join me in urging this Committee to consider Mr. Risk's suggestion including guidance.

Mr. Ricci also states that issuing positive guidance would have a detrimental effect on the usage of structured settlements. Mr. Ricci cites no authority or study for this position, and indeed, NSSTA's own data would seem to support an entirely different position, in conclusion.

NSSTA's annual measurement of the growth of the industry seems to coincide with the proliferation in QSFs as the structured settlement industry has seen premiums grow from approximately four billion in the mid '90s to over six billion in the year 2008. Now, admittedly, some of this growth can be attributed to inflation in the general economy as well as inflation in medical expenses for our injury victims.

However, over this same timeframe, we have seen a proliferation of QSF's, Qualified Settlement Funds. In my office, I have been involved in over 200. My associates and peers have been involved in many hundreds more. One would think that with this dramatic increase in the usage of QSF's, that the utilization of structured settlements would have dropped if Mr. Ricci is to be believed. To the contrary, their utilization has increased. Why is this?

I'd like to give a brief history of this industry as I have seen it. In 1985, when I entered nearly complete control of this industry, it was through the defense side. They selected their brokers, they dictated the annuity companies and trust companies that the plaintiff would use. Plaintiff specialists like myself were denied access to the annuity markets by life insurance companies. Defendants, in essence, held 104A captive; as Mr. Risk described it, the carrot at the end of the

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stick. The plaintiffs could not give the benefits of 104 unless they accepted defense's choices of not only their brokers but the annuity companies, where they wanted the business to go. Also, most cases, no matter how large, were funded with a single annuity from one just -- from just one life insurance company. The plaintiffs at the time, many plaintiffs rejected structured settlements simply because they couldn't choose their own expert and they ultimately couldn't choose the companies that would be responsible to them. And they couldn't, in many cases, buy the fact that the people who caused their injuries would somehow profit from the settlement of their claim, and they could do nothing about that.

In 1988 through 1990, the Wild lawsuit occurred, and this, in essence, resulted in life insurance company appointments for people who worked on the plaintiff's side of the business. Up until that time, we couldn't even get access to the annuity markets with which to help these injury victims that we represented, a landmark situation for us.

In 1991, Executive Life of California went through a solvency crisis and entered conservatorship. First time in history that some personal injury victims suffer a partial loss of payment due to this insolvency. Diversification of annuity company risk becomes imperative from this time forward and plaintiffs begin to look for their own experts. 1992, regs regarding QSF's were issued; '96, the industry recognizes that QSF's have game changing potential as personal injury victims and no longer have to be subject to the disclosed or undisclosed financial agendas of the people who caused their injuries.

Defendants have sought to make all the choices for plaintiffs without remaining accountable or reliable for those choices. Instead, we see exactly what they were entitled to, a full, complete and irrevocable release from liability, nothing else.

Personal injury victims could now choose their own advisors and then select the companies. The annuity issuers and the trust companies would ultimately be responsible to them for their future payments. And they could diversify the risks in these transactions by selecting two or more companies as their guarantors.

2001, SSP is formed. Why? Because the NSSTA did everything in its power to marginalize those of us who work for plaintiffs, and NSSTA was perceived to be working against the rights of plaintiffs to choose who they wanted to work with. Also, the organization had become dominated by insurance companies, whose agendas included controlling commission flow from annuity policies so that portions of those commissions could be captured as profits. Also, the term "asset retention" became very popular at this time as insurance companies sought to capture claim dollars and transfer them to wholly owned insurance company annuity issuer affiliates. SSP believed that 104A2 was meant to benefit injury victims, not the --

2002, the use of QSF's explodes. NSSTA members pushed back, claiming that one or more language does not mean "one or more", and that economic benefit doctrine would apply. 2003, SSP submits request to Treasury for published guidance. IRS adds it to their business plan, 2004.

2008, financial meltdown. AIG and Hartford, big structured settlement annuity providers, both are in the forefront.

Interestingly, these two companies, along with the Department of Justice, are the two biggest or the three biggest perpetrators of forcing plaintiffs to follow their agenda and follow their will in where they want the settlement and claim dollars to go, with DOJ even denying claimants the right to have their own expert and to have that expert compensated out of the transaction that ultimately settled their case. So now here we are, and I on behalf of future personal injury victims, and the professionals that work with them, both financial and legal planners across the country, respectively ask you to consider adding positive guidance to 104A regarding single claimant QSF's: that economic benefit does not apply to disqualify a qualified assignment.

MS. CRISALLI: Do you think that plaintiffs really have no power to push back on defendants in terms of how they -- where they go for the structured settlement without using a QSF?

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MR. MILLIGAN: Prior to --

MS. CRISALLI: I mean do they have people like you to support them and advocate for them?

MR. MILLIGAN: -- prior to the creation of Qualified Settlement Funds in 468 cap B, it was extremely difficult. The personal injury victim had to have an exceptionally strong legal advocate to gain any traction at all.

MS. CRISALLI: Well, how about now?

MR. MILLIGAN: Now we have the QSF.

MS. CRISALLI: Without the QSF, if you don't use a QSF.

MR. MILLIGAN: Well, that's like saying let's roll the ball back up the hill and imagine what the situation would be. If we didn't have QSF's, I imagine it would be the same as it was prior. But now, because of their existence, we can't really put that genie back in the bottle, and what has happened is that the mere fact that QSF's are available is enough to persuade many times the defense side of these cases that they should try to acquiesce to the plaintiff's demand.

MS. CRISALLI: Well, that's my point exactly.

MR. MILLIGAN: Okay.

MS. CRISALLI: Is it the mere threat of the QSF helpful?

MR. MILLIGAN: It is, except in the case where we now have companies and the Department of Justice who are, as part of the negotiations, telling the plaintiff, if you think you're going to use a Qualified Settlement Fund, think again, we will oppose it, it's a risky tax transaction, it's not proven, we believe economic benefit would apply, and the tax consequences would also come back to us on the defense side.

MS. CRISALLI: I assume then that plaintiffs that use QSF's are applying the 104A2 exclusion?

MR. MILLIGAN: Yes.

MS. CRISALLI: They're not treating it as taxable?

MR. MILLIGAN: Yes, that's true.

MS. CRISALLI: Okay.

MR. MILLIGAN: And single claimant QSF's are being used around the country for those brave enough to step out and say, my advisors have told me, explained what the code says, that these can be used for one or more claims, and I'm going to believe that the code says what it says.

MS. CRISALLI: Thank you.

MR. MONTEMURRO: Okay. Is there anybody else who would like to speak?

MR. LEYDEN: Good morning, Mr. Chairman, ma'am. I am Edward Leyden, I'm here -- I'm a partner at the law firm Hallwell Leyden, but I'm here today in my capacity as President of Consumers for Civil Justice. At Consumers for Civil

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Justice, there's a *Section 501C6* trade association comprised of attorneys here in the metropolitan Washington, D.C., area who fight for the rights of people that have suffered harm from discrimination and from the wrongful acts and omissions of others, in short, the plaintiff spot, as we've heard described. We view the tax policies underlying *Section 104A2* to be both wise and well founded because the financial compensation that one may receive in a court of law or as the result of a legal settlement for physical harm and pain is certainly not an accretion of wealth by any measure. It is, thus, entirely fair and proper that such sums be statutorily excluded from income and not subject to taxation.

CCJ further applauds the clarification that the Service is linked to *Section 104A2* and that that -- since 1996, when Congress substantially modified the statute, and especially the thought and insight that went into the proposed regulations that are the subject of this hearing today.

However, we do echo the concerns expressed by Stuart Lewis in the American Bar Association section of taxation concerning the need to clarify that compensation, for physical injuries and sickness comes within the ambit of Section 104A2, even if such harm resulted from a wrongful act that did not encompass physical contact or touching. Such qualification will be manifestly continent with the policy considerations underlying these proposed regulations and of a whole with the thoughtfulness and compassion that ultimately animates them. In the interest of full disclosure, I should point out that while I'm a currently serving officer of the ABA Section of taxation, at which I share the Committee for Employment Taxes, that's not the capacity that I'm here today, and I had no part in writing or preparing the comments that the ABA tax section itself submitted.

I thank you for this opportunity to testify on behalf of our Association, and, of course, would be delighted to answer any questions that I may.

MR. MONTEMURRO: Fine.

MR. LEYDEN: Thank you.

MR. MONTEMURRO: Very good. Okay. Is there anybody else who would like to speak this morning? Okay. Then I thank you all for coming this morning and setting forth your views, and we'll be working here on the regulations and trying to move them toward the final product, and I think you all for coming, and the hearing is adjourned.

(Whereupon, at 11:08 a.m., the HEARING was adjourned.)

3 of 71 DOCUMENTS

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OCTOBER 07, 2009, WEDNESDAY

DEPARTMENT: Public Comments on Regulations

CITE: *2009 TNT 192-21*

LENGTH: 5711 words

HEADLINE: 2009 TNT 192-21 ATTORNEY SUGGESTS CHANGES TO PROPOSED REGS ON EXCLUSION OF PHYSICAL INJURY OR SICKNESS DAMAGES. (Section 104 -- Damage Awards/Sick Pay) (Release Date: OCTOBER 01, 2009) (Doc 2009-21897)

CODE: *Section 104* -- Damage Awards/Sick Pay;
Section 130 -- Personal Injury Liability Assignments;
Section 451 -- Year of Inclusion;
Section 468B -- Designated Settlement Funds

ABSTRACT: Richard B. Risk Jr. of the Risk Law Firm, in comments on proposed regulations on the removal of the requirement that personal injury damages be based on tort or tort-type rights, has asked the IRS to publish rules on the application of the economic benefit doctrine to amounts received to resolve claims.

SUMMARY: Published by Tax Analysts(R)

Richard B. Risk Jr. of the Risk Law Firm, Tulsa, Okla., in comments on proposed regulations (REG-127270-06) on the removal of the requirement that personal injury damages be based on tort or tort-type rights, has asked the IRS to publish rules on the application of the economic benefit doctrine to amounts received to resolve claims and has suggested various changes for incorporation into *reg. section 1.104.*

AUTHOR: Risk, Richard B.
Risk Law Firm

GEOGRAPHIC: United States

REFERENCES: Subject Area:
Individual income taxation

Cross Reference:
For REG-127270-06, see *Doc 2009-20411* or *2009 TNT 176-6.*

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TEXT:

Release Date: OCTOBER 01, 2009

Published by Tax Analysts(R)

From: Dick Risk [Mailto:dick@risklawfirm.com]
Sent: Thursday, October 01, 2009 2:01 PM
To: Hurst Richard A
Cc: Iskow Sheldon A
Subject: Proposed Rules DOCID: fr15se09-26 FR Doc E9-22221

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Subject: Proposed Rules DOCID: fr15se09-26, FR Doc E9-22221, 26 CFR Part 1, Para. 2, Sec. 1.104-1(c), Compensation for injuries or sickness

"[T]he Secretary of the Treasury shall prescribe all needful rules and regulations for the enforcement of this title [Title 26, U.S. Code]." -- I.R. C. section 7805(d)

The Service has issued proposed Income Tax Regulations that would amend section 1.104-1(c), "Compensation for injuries or sickness," very narrowly to reflect amendments under the Small Business Job Protection Act of 1996 and to delete the requirement that, to qualify for exclusion from gross income, damages received from a legal suit, action, or settlement agreement must be based upon "tort or tort type rights." The Service would be remiss in fulfilling its duty, on behalf of the Secretary of the Treasury, to "prescribe all needful rules and regulations for the enforcement of the Internal Revenue Code, for this section of the regulations has always lacked the inclusion of important legislative history, dating to the Periodic Payment Settlement Act of 1982. It is the intent of Congress that the setting aside of funds in trust for a recipient to produce periodic payments, which generally confers an economic benefit and results in income to the recipient in the year of setting aside the funds, is allowed without regard to whether the recipient has the current economic benefit or constructive receipt of the sum required to produce the periodic payments, and any amount received pursuant to the exclusion prescribed in *section 104(a)(2)* will not be included in the recipient's gross income.

This issue encompasses at least Code *sections 104*, 130, 451 and 468B, and perhaps 83. It has been identified by Treasury and the Service in a narrow form and first appeared on the Office of Tax Policy and Internal Revenue Service 2004-2005 Priority Guidance Plan under the heading, Tax Accounting, as "Guidance under *section 468B* regarding the tax treatment of a single-claimant qualified settlement fund." This can just as well be classified as a *section 104* issue, as *sections 130*, 451 and 468B are inextricably linked to each other. With the insertion of a single subparagraph in *regulations section 1.104-1(c)* that is consistent with clear congressional guidance and with previous rulings of the Service, this important issue is resolved, not just for designated settlement funds and qualified settlement funds derived from *section 468B*, but for any entity where damages have been deposited to resolve or satisfy claims when current year recognition of the payments is meant to be avoided, including but not necessarily limited to the entities that assume a periodic payment obligation under a *section 130* "qualified assignment."

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Recommendation:

I recommend the inclusion of the following text after subparagraph (2), as separate subparagraph (3), and that the currently proposed subparagraph (3) is renumbered as (4):

(3) Amounts received as damages into a fund, account, or trust that is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability do not result in income to the intended recipient in the year of setting aside the funds without regard to whether the recipient has the current economic benefit or constructive receipt, as defined in regulations section 1.451-2(a), of the sum required to produce the periodic payments or that may be distributed from the fund, account or trust in a subsequent year. The fund, account or trust must be a trust under applicable state law, or its assets must be otherwise segregated from other assets of the transferor (and related persons). This applies to amounts received under a "qualified assignment" of a periodic payment obligation pursuant to Code *section 130(c)* or by a designated settlement fund or qualified settlement fund established pursuant to Code *section 468B* and/or Income Tax *Regulations section 1.468B-1(c)*, but without limitation to these two types of entities. Payments that qualify for exclusion from the recipient's gross income under Code *section 104(a)(2)* will still qualify for exclusion without regard to whether the recipient had economic benefit or constructive receipt of the amount prior to its distribution, whether paid from an obligor of a *section 130(c)* "qualified assignment," from a *section 468B* entity, or in any other fashion. Recognition of payments that do not qualify for the *section 104(a)(2)* exclusion similarly can be deferred until the years in which the distributions are made, without regard to whether the recipient has had economic benefit or constructive receipt of the amounts while held by the fund, account or trust.

The Document Summary in the announcement would need to be expanded to incorporate this additional guidance.

Background and Explanation:

The Periodic Payment Settlement Act of 1982 added *section 130* and amended *section 104(a)(2)* to exclude personal injury damages received as periodic payments from the recipient's gross income, whether by suit or agreement. Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, *section 104(a), 96 Stat. 2605, 2605 (1983)* (codified at *I.R.C.*

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section 130). The new provision of *section 104(a)(2)* was intended to codify existing law as reflected in Revenue Rulings 77-230, 79-220 and 79-313. *See Rev. Rul. 77-230, 1977-2 C.B. 214; Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.)*

Congress created an exception to the broad rule established by case law defining economic benefit as applied to structured settlements. H.R. REP. NO. 97-832, pt. II, at n.2 & Explanation of Provisions (1982). *Revenue Ruling 79-220* was one of three key rulings that were later codified by the Periodic Payment Settlement Tax Act of 1982. The facts of that ruling were as follows:

> [T]here is a continuing obligation by *M* to $ 250 per month to *A* for the agreed period. *M*'s purchase of a single premium annuity contract from the other insurance company was merely an investment by M to provide a source of funds for M to satisfy its obligation to *A*. See *Rev. Rul 72-25, 1972-1 C.B. 127,* which relates to a similar arrangement made by an employer to provide for payment of deferred compensation to an employee. In *Rev. Rul. 72-25,* as here, the arrangement was merely a matter of convenience to the obligor and did not give the recipient any right in the annuity itself. *Rev. Rul. 79-220, 1979-2 C.B. 74.*

On these facts, the Service held:

> The exclusion from gross income provided by section *104(a)(2) of the [Internal Revenue Code* of 1954] applies to the full amount of the monthly payments received by *A* in settlement of the damage suit because *A had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump-sum that was invested to yield that monthly payment* (emphasis added). If *A* should die before the end of 20 years, the payments made to A's estate under the settlement agreement are also excludable from income under section 104.

Under the facts of *Revenue Ruling 79-220,* the single premium immediate annuity purchased by *M* as a convenience to *M* to fund its obligation to *A* is an amount set aside irrevocably for *A*'s sole benefit. Economic benefit applies, according to *Sproull,* when assets are unconditionally and irrevocably paid into a fund or trust to be used for a taxpayer's sole benefit. *Sproull v. Commissioner, 16 T.C. 244, 247-48 (1951).* However, as in *Sproull,* the deciding factor in *Revenue Ruling 79-220* was control. Sproull alone had an interest in or control over the monies in the trust and was therefore required to take no further action to earn or establish his rights to the amounts in trust. *A,* in contrast, had a right to receive only the monthly payments and thus had no right or control over the annuity. *A* was a single claimant.

In the House of Representatives Report accompanying the Periodic Payment Settlement Tax Act of 1982, the Committee on Ways and Means summarized the present law pertinent to this issue in its "Explanation of the Bill," as follows:

> *Rev. Rul. 79-220* holds that where the insurer of

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> a tortfeasor purchases and retains exclusive ownership of a single-premium annuity contract to fund specified monthly payments for a fixed period pursuant to settlement of a damage suit for personal injuries, the recipient may exclude from his or her gross income the full amount of the payments, and not merely the discounted present value. *The taxpayer's only right with respect to the amount invested was to receive the monthly payments, and the ruling concluded that the taxpayer did not have actual or constructive receipt or economic benefit of the amount invested.* H.R. REP. NO. 97-832, pt. II, at n.2 (1982) (emphasis added).

The same report, under reasons for change, clarified that Congress was accepting the Service's decision on the underlying facts of *Revenue Ruling 79-220.* It agreed with the Service that neither actual or constructive receipt nor economic benefit of the amount invested was triggered. The Report explained that

> [t]he bill specifically provides that the Code *section 104* exclusion from gross income of damages for personal injuries or sickness applies whether the damages are paid as lump sums or as periodic payments. *This provision is intended to codify, rather than change, present law.* Thus, the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments. *Id.* at pt. II (emphasis added). The pertinent text is identical in the Senate version of the report to accompany H.R. 5470. S. REP. NO. 97-646, at 4 (1982)

Thus, Congress expressed its intent that, in structured settlements, the judicial doctrine of economic benefit does not apply simply because a sum is set aside irrevocably for the payee's sole benefit -- even if the payee is the only claimant who will benefit from the sum set aside. Certainly, Congress intended a bright line distinction in that economic benefit attaches only when the claimant is given control over the sum. Now that Congress has spoken on the issue by adopting the Service's interpretation as its own, neither Treasury nor the Service may override it. It is highly appropriate that the Service now -- some 27 years since the enactment of the Periodic Payment Settlement Tax Act of 1982 -- should acknowledge that its original interpretation has been memorialized in the legislative intent of the Tax Code by including it in the Income Tax Regulations.

Congress has shown that it did not intend the judicial doctrine of economic benefit to apply to a designated settlement fund (DSF) or qualified settlement fund (QSF) created for the benefit of a single claimant. The single claimant would not have access to the amount transferred into the DSF/QSF because it is: (1) controlled by the DSF/QSF administrator, who is independent of the claimant; (2) subject to the continuing jurisdiction of a court or other governmental agency; and (3) not even dedicated to the claimant's benefit until a settlement agreement between the claimant and the DSF/QSF is executed. *Revenue Ruling 79-220* held that when funds or an asset (annuity) are held for the benefit of a claimant (a single claimant under those facts) to provide periodic payments, and the claimant has no control over those funds, the claimant does not have constructive receipt or economic benefit of those funds. Under the facts of *Revenue Ruling 79-220,* the claimant was entitled to receive periodic payments generated by the assets being held for the claimant's

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benefit. Where the assets are simply being held in the DSF/QSF, the claimant has no rights to future payments until a settlement agreement is executed. This creates additional distance between the funds and the claimant that did not exist in the facts of *Revenue Ruling 79-220,* strengthening the argument that there is no economic benefit.

Congress specifically agreed, through the legislative history of both the House and Senate for the Periodic Payment Settlement Tax Act of 1982, with the Service's interpretation and findings in *Revenue Ruling 79-220.* It accepted that neither constructive receipt nor economic benefit should apply when the single claimant had no control over the funds being held for his benefit. *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 976-473, *96 Stat. 2605 (1983)* (codified at *I.R.C. section 104(a)*); H.R. CONF. REP. NO. 97-984 (1982); H.R. REP. No. 97-832, pt. II, n.2 (1982); S. REP. 97-646, pt. II, n.2 (1982). Congress expressly stated that it was codifying the existing law. H.R. REP. NO. 97-832, pt. II, Explanation of Provisions (1982).

Congress has indicated through subsequent legislation, such as the Technical and Miscellaneous Revenue Act of 1988 and the Victims of Terrorism Tax Relief Act of 2001, that the economic benefit doctrine should not be expansively interpreted. The narrower definition of economic benefit provides the claimant some rights for the payee in the funding asset itself that *Sproull* and successive case law had not allowed previously in defining the broad rules of the economic benefit. *See Sproull v. Commissioner, 16 T.C. 244 (1951).*

Congress has softened its stand on the economic benefit doctrine and whether it renders a periodic payment obligation, excluded from the recipient's gross income under *section 104(a)(2)* unassignable under *section 130.* As initially enacted in 1982, *section 130* restricted the rights a claimant has against the assignee and in the assets used to fund future periodic payments. *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, *section 101, 96 Stat. 2605, 2605-2606 (1983)* (codified at *I.R.C. section 130*). Congress repealed *section 130(c)(2)(C)* in 1988 because, in Congress's view, "[r]ecipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of the tax law." H.R. REP. No. 100-795, at 541 (1988). *I.R.C. section 130(c)(2)(C)* (repealed 1988). Public Law 100-647, *section 6079(b)(1)(A),* deleted Code *section 130* subparagraph (c)(2)(C) and redesignated subparagraphs (c)(2)(D) and (c)(2)(E) as subparagraphs (c)(2)(C) and (c)(2)(D). Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, *section 6079(b)(1)(A), 102 Stat. 3342, 3710 (1988).* The deleted subsection read as follows: "(C) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor." *26 U.S.C.A section 130,* History, Ancillary Laws and Directives (1999).

Congress also provided much greater rights to payees in structured settlements with the enactment of the Victims of Terrorism Tax Relief Act of 2001, which added *section 5891 to the Code. See* Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, *115 Stat. 2427* (codified at *I.R.C. section 5891*). *Section 5891* regulates factoring transactions by imposing a forty percent federal tax on the factoring discount unless approved in advance by an applicable state court. *I.R.C. section 5891(a).* This section also gives payees the ability to transfer structured settlement payment rights (including portions of structured settlement payments) made for consideration by means of sale, assignment, pledge, or other form of encumbrance or alienation for consideration. *Id. section 5891(c)(3)(A).* These new rights go far beyond those of the payee in *Revenue Ruling 79-220.* Under that ruling, the payee could receive only the monthly payments -- he could not have the actual or constructive receipt or the economic benefit of the lump sum that was invested to yield that monthly payment.

The developments following the codification of *Revenue Ruling 79-220* in the Periodic Payment Settlement Tax Act of 1982 indicate that a more lenient interpretation of constructive receipt and economic benefit is appropriate for structured settlements. The definitions of constructive receipt and economic benefit are to be construed much more narrowly when applied to structured settlements than to other deferred compensation situations when congressional intent is considered.

The technical arguments of congressional intent are straightforward, gleaned from the statutes and their amendments as well as committee reports. Based on these sources, it is apparent that Congress did not intend for the judicial doctrine of

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economic benefit to apply to the facts of any entity that can assign periodic payment obligations, without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments, including but not necessarily limited to assignment from a designated settlement fund or qualified settlement fund created for the benefit of a single claimant.

Congress has expressly noted on these several occasions noted herein that economic benefit does not attach in structured settlement situations as easily as it might attach in other types of deferred compensation agreements. Court decisions in this area likewise suggest that a narrow interpretation of economic benefit is appropriate in the case of structured settlements. In *Childs v. Commissioner*, the Tax Court rejected the Service's position that the right of attorneys to receive periodic payments on behalf of their clients, in satisfaction of the clients' debt for attorney fees, was funded or secured. *103 T.C. 634 (1994), aff'd 89 F.3d 865 (11th Cir. 1996).*

The court held that the cost of the annuity contract funding the structured settlements received by the taxpayers in satisfaction of attorney's fees represented mere "unfunded promises," and did not constitute "property" under *section 83.* Therefore, it was not taxable in the year of purchase. The issue appealed by the Service to the Eleventh Circuit was whether the purchase price of the annuities constitutes "property" per Code *section 83* and, if so, whether that "property" was transferred. The circuit court rejected the Service's position and upheld the Tax Court ruling. *Childs v. Commissioner, 89 F.3d 865, 865 (11th Cir. 1996).*

Decisions by the courts also suggest a narrower definition of economic benefit in the case of structured settlements. The Tax Court's decision in *Childs*, as affirmed by the Eleventh Circuit, confirms that the economic benefit doctrine does not apply even to attorneys who collect all or part of their attorney fees in periodic payments from clients entitled to damages excluded under *section 104(a)(2). I.R.C. section 104(a) (2); Childs v. Commissioner, 103 T.C. 634 (1994), aff'd, 89 F.3d 856 (11th Cir. 1996).* Congressional action and the decision in *Childs* provide controlling authority that economic benefit does not attach to any payee in a structured settlement, so long as the payee has only the rights to the future payments and does not control the qualified funding asset. The claimant may, however, have a right to a security interest in the funding asset, and he may sell, assign, pledge, encumber by some other form, or alienate by consideration the future payments.

The basic economic doctrine remains intact if Treasury and the Service issue the written guidance requested on whether a QSF established for the benefit of a single claimant may make a qualified assignment within the meaning of *section 130.* This is a carve-out that provides exceptions to the broad rule. The difference between structured settlements and other garden-variety deferred compensation agreements is easily distinguishable.

Previous rulings by the Service that would be codified by this proposal:

The Service cited *Sproull* in *Revenue Ruling 2003-115,* issued as guidance for those opting for periodic payments from the September 11th Victim Compensation Fund of 2001. *Revenue Ruling 2003-115* provides the necessary guidance for a structured settlement with a QSF established for the benefit of a single claimant:

> The economic benefit doctrine, developed in case law, provides that if a promise to pay an amount is funded and secured by the payor, and the payee is not required to do anything other than wait for the payments, an economic benefit is considered to have been conferred on the payee and the amount of such benefit is considered to have been received. In *Sproull*, the court found that an economic benefit had been conferred on a taxpayer when the taxpayer's employer established a trust to compensate the taxpayer

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> for past services. In 1945, the employer transferred money to the trust to be paid to the taxpayer in 1946 and 1947. The taxpayer was the trust's sole beneficiary. The court held that the taxpayer received compensation in 1945 in an amount equal to the value of the amount transferred to the trust for the taxpayer's benefit because such transfer to the trust provided the taxpayer with an economic benefit.
>
> Not all rights to receive periodic payments, however, trigger application of the economic benefit doctrine. *Rev. Rul. 79-220, 1979-2 C.B. 74,* concludes that a right to receive certain periodic payments under the facts of the ruling does not confer an economic benefit on the recipient. In *Rev. Rul. 79-220,* a taxpayer entered into a settlement with an insurance company for the periodic payment of nontaxable damages for an agreed period. The taxpayer was given no immediate right to a lump sum amount and no control of the investment of the amount set aside to fund the insurance company's obligation. The insurance company funded its obligation with an annuity payable directly to the taxpayer. The insurance company, as owner of the annuity, had all rights to the annuity and the annuity was subject to the claims of the general creditors of the insurance company. The ruling concludes that all of the periodic payments are excluded from the taxpayer's gross income under *section 104(a)(2)* because the taxpayer did not receive, or have the economic benefit of, the lump sum amount used to fund the annuity. Further, the ruling holds that if the taxpayer dies before the end of the agreed period, the payments made to the taxpayer's estate under the settlement agreement are also excludable from the gross income of the estate under section 104(a)(2).

The issue in PLR 97-03038 was whether a trust may act as an assignee for purposes of *section 130 of the Code*:

> Under the facts presented, the assignee of the defendant's obligation to make periodic payments is T, a trust. T receives a lump sum from the defendant, from which it will make the periodic payments to the plaintiff. T uses the lump sum to purchase funding assets. T holds the funding assets in its name, grants the plaintiff a security interest in the funding assets, and uses the payout from the funding assets to fund the periodic payments.

On these facts, the Service ruled:

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> Generally, the setting aside of funds in trust for a recipient confers an economic benefit and results in income to the recipient in the year of setting aside the funds. See *Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff'd per curiam., 194 F.2d 541* (6th Cir. 1952). However, the 1988 amendment to section *130(c) of the Code* was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments. Therefore, assuming all other requirements of section 130(c) are met, an assignment of liability to T as assignee will be treated as a qualified assignment under *section 130(c)*. Further, any amount received by T for agreeing to a qualified assignment will not be included in T's gross income to the extent such amount does not exceed the aggregate cost of any qualified funding assets as defined in section 130(d).

The Service also ruled previously, in PLR 97-36032, in favor of four taxpayers who were each sole beneficiaries of identical qualified settlement funds, declaring *"no inclusion in gross income will be required of the beneficiaries of the funds as a result of the transfer of settlement proceeds to funds."* Obviously, the Service found that economic benefit did not attach simply because the QSF was established for the benefit of a sole individual. There was no "qualified assignment" of periodic payments. In fact, there were no periodic payments, and the sums to be paid were to be taxed to the recipients in the years in which the payments are received.

In *PLR 200836019,* the Service recognized the concept of a "non-qualified assignment" and that such an arrangement can also defer current year recognition of the amounts received by a fund, account or trust not organized under the provisions of Code *section 130* or 468B. The Service said:

> Neither the execution of the Non-Qualified Assignment nor the purchase of an annuity contract by the Assignee to fund its obligation to the taxpayer shall be viewed as conferring a current economic benefit on the taxpayer. After the execution of the Non-Qualified assignment, the taxpayer will possess only a mere promise to be paid (although the identity of the promisor will have changed), Moreover, no amount will be set aside from which to make the scheduled payments, nor will a separate fund to irrevocably and unconditionally set aside for the benefit of the taxpayer. Furthermore, taxpayer has no rights against the Assignee other than that of a general creditor.
>
> Based on the above, neither the "constructive receipt" doctrine, the "cash equivalency" doctrine, nor the "economic benefit" doctrine shall apply to the taxpayer's acts regarding the Periodic Payments.

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Thus, the guidance proposed for inclusion in the revised *section 1.104 of the regulations* is not confined to funds, accounts or trusts organized under Code *section 130* or 468B, nor is it confined to amounts that will be paid under the exclusion from gross income provided by *section 104(a)(2)*. Consistent with previous rulings, recognition by the intended recipient(s) of the amounts received by the fund, account or trust may be deferred to the years in which the distributions are made.

It is conceded that a private ruling may not be used or cited as precedent, per Code *section 6110(k)(3)*, unless the Secretary of the Treasury establishes otherwise by regulations. However, the U.S. Supreme Court determined in *Hanover Bank v. Commissioner, 369 U.S. 672, 686-87 (1962)*, that private rulings issued by the Service reflect that agency's interpretation of the statute and, thus, may be used as evidence in litigation of tax matters. Previous rulings by the Service, including private letter rulings intended only for the requesting taxpayer, should be incorporated in published rules when necessary to provide "all needful rules and regulations," as required by Code *section 7805(d)*. Previous rulings on the issue of economic benefit and constructive receipt of damage amounts held in a fund, account or trust for later distribution should be codified. This proposed revision to *section 1.104 of the Income Tax Regulations* offers a perfect and timely opportunity to do so.

As a practitioner who has been involved in periodic payment tax issues since 1986, I can attest to the need for published rules on the application of the economic benefit doctrine to amounts received to resolve claims. I urge Treasury and the Service to adopt the text I have proposed, and incorporate it into Income Tax *Regulations section 1.104*.

References:

23 Va. Tax. Rev. 639 (2004), Richard B. Risk, Jr., *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund for a Single Claimant.*

2008 TNT 30-19, Richard B. Risk, Jr., *Attorney Comments on Forthcoming Guidance on Use of Qualified Settlement Funds for Benefit of Single Claimant.*

Federal Register notice link: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?
c=ecfr&sid=e257b9bdbbc4eaec2e623d8018c0bcla&rgn=div8&view=text&node=26:2.0.1.1.1.0.4.10 9&i

Current Income Tax *Regulations section 1.104* link:

http://www.thefederalregister.com/d.p/2009-09-15-E9-22221

Request for a Public Hearing:

I respectfully request that a public hearing be held on this matter and that I be notified directly of its time and place, so that I have the opportunity to appear.

As a practitioner who has been involved in periodic payment tax issues since 1986, I can attest to the need for published rules on the application of the economic benefit doctrine to amounts received to resolve claims. I urge Treasury and the Service to adopt the text I have proposed, and incorporate it into Income Tax *Regulations section 1.104*. This is just as appropriate to be indexed with rules for Code *section 104* as it would be for *section 130*, 451 or 468B.

I submit this recommendation on my own behalf, not on behalf of anyone else or any organization to which I belong or am affiliated.

Respectfully submitted,

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REMARKS OF:
RICHARD B. RISK, JR., ESQ.
BEFORE THE INTERNAL REVENUE SERVICE
WASHINGTON, D.C.
PERTAINING TO PROPOSED REVISION OF 26 C.F.R. § 1.104
FEBRUARY 23, 2010, 10 A.M.

NOTE: TIME CONSTRAINTS PREVENTED THE ORAL DELIVERY OF THIS ENTIRE TEXT. SEVERAL PARAGRAPHS WERE NOT READ ALOUD. THESE PREPARED COMMENTS WERE HANDED TO THE REPORTER FOLLOWING THE HEARING, ALONG WITH MY *VIRGINIA TAX REVIEW* ARTICLE, CITED IN THESE REMARKS. FOLLOWING IS WHAT I WOULD HAVE READ IF GIVEN ADEQUATE TIME.

Mr. Chairman, ladies and gentlemen, thank you for the opportunity to appear at this hearing. My name is Richard B. Risk, Jr. I reside in both Tulsa, Oklahoma, and St. Petersburg, Florida. I am an attorney whose entire law practice focuses on the aspects of tort claim settlements. I have written documents to establish more than 250 qualified settlement funds and have administered the majority of them. I have been published extensively in legal journals and have chaired tax panels for a professional association, the Society of Settlement Planners, including guest panelists from Treasury and the Internal Revenue Service. I am appearing today on my own.

Structured settlements are a very important tool in the resolution or satisfaction of claims originally asserted by injury victims against the tortfeasors after the liability for such claims has been transferred by novation to the qualified settlement fund. I will get to the tax issues in a few minutes, but first I want to present a little background on the undercurrent within the structured settlement industry that may serve to explain why we may have differences of opinion among ourselves as to how the Tax Code should be interpreted.

I first came into the structured settlement community in 1986 as a producer and eventually joined the National Structured Settlements Trade Association because it was required of anyone who sought to be appointed by the major annuity markets. At the time I joined the trade association, the marketing orientation for structured settlements was almost entirely from the defense side. Structured settlement producers worked with corporate risk managers and liability insurance claim adjusters to propose periodic payments to injury victims, along with the attractive tax subsidy, as a way the responsible party could save money in settling claims.

If the claimant or claimant's attorney wanted to know the cost of the funding asset—the annuity—the response was that knowledge of the amount would cause the claimant to be in constructive receipt of the funding asset and, thus, would lose the tax benefits.

If the claimant felt uncomfortable allowing the structured settlement producer engaged by the defendant to handle perhaps the biggest financial transaction of the claimant's life, and wanted to engage a consultant with a fiduciary duty to the claimant, the response was "take the structure that we offer or take cash." These were hardball tactics designed to keep control of the structured settlement process for the defendants and their insurers. Loss of control meant loss of a money-saving tool for the defense and, in some cases, it also meant the loss of profitable annuity business for insurance groups that had life insurance affiliates, because the liability insurer could control where a significant amount of settlement dollars were spent. The National Association of Insurance Commissioners calls this practice "steering" and describes it as an "inappropriate solicitation activity."

Loss of control of the structured settlement transaction also meant the loss of sales commissions paid by the life insurance companies to life insurance agents who like to call themselves "brokers," as a reward for their efforts on behalf of the defendants or their insurers.

When one thinks about it, the refusal by the defense to allow an injury victim the right to engage his or her own structured settlement specialist to handle the periodic payment arrangement is morally indefensible. After all, the claimant was the ultimate consumer of the annuity, even though tax considerations prevent actual ownership.

By the mid-1990s, the defense canard that knowledge of an annuity's cost causes constructive receipt had been revealed to the plaintiff's bar as untrue, and the amount of the proposed annuity premium to be spent by the defense became integral to the settlement negotiations. The mediation paradigm had shifted from "we offer you a cash lump sum and periodic payments as described in this proposal" to "let's settle on the total cost to the defense of settlement, and then we'll decide how much will be spent on the periodic payments." With that paradigm shift, the commission for the annuity sale, which was bundled into the annuity premium was now part of the gross settlement amount offered by the defense. And, the issue became which side had the right to pay its structured settlement specialist using the built-in commission. Claimants began to assert that the commission was part of the settlement offer and, therefore, they were entitled to engage the services of a structured settlement specialist loyal to them and to use the commission as compensation. This notion upset the unconscionable marketing model built by the liability insurance claims departments and structured settlement agencies when they were in total control of structured settlements, and the battle over who gets the commission still rages today.

The Society of Settlement Planners was formed in 2001 to promote the rights of plaintiffs. In 2003, several members of the SSP risked losing their life insurance company appointments by resigning their memberships in NSSTA. It was obvious to them that NSSTA did not represent their interests and that the trade association was spending their dues on causes adverse to their interests. The life insurance markets evidently realized that this group of advocates for plaintiff rights represented a large block of annuity premium production, and did not terminate their appointments, apparently changing their former stance that those appointed to sell structured settlement annuities must be members of NSSTA.

One of the reasons for the success of these plaintiff-oriented structured settlement producers was the use of the qualified settlement fund. Plaintiff's lawyers who were concerned about their own exposure to legal malpractice claims by their own clients for allowing the defense to take control of their clients' financial future became enamored with the qualified settlement fund. They could give the defendants an immediate release and dismiss them from the litigation while preserving the opportunity for their clients to structure—without the pressures of quick decision making that usually occur at mediations, and without the involvement of the opposing side.

These resignations in 2003 by a number of successful structured settlement producers were also very significant because it meant, for the first time, NSSTA did not represent the entire structured settlement industry. NSSTA cannot seem to let go of its claim to represent the entire structured settlement community, as they arrogantly repeat that claim whenever they think somebody will listen. But, it is a blatant misrepresentation of their constituency.

The Society of Settlement Planners decided to demonstrate its independence from NSSTA in June 2003 when it asked Treasury to clarify the tax treatment of a section 130 qualified assignment of a periodic payment obligation when made by a qualified settlement fund that was established to settle with a single claimant. The request was signed by three distinguished alumni of the Service: Jody J. Brewster, former assistant chief counsel, Income Tax and Accounting; Kenneth W. Gideon, former chief counsel; and Fred T. Goldberg, former chief counsel and commissioner. Mr. Gideon and Mr. Goldberg both also served as assistant secretary of the Treasury for Tax Policy. All three are law partners at Skadden, Arps, Slate, Meagher & Flom, LLP.

I subsequently wrote an article published in the *Virginia Tax Review* (23 Va. Tax Rev. 639), titled "A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant." I submit that article for the record. When the editor wrote to me in April 2004, I believe, that the final editing was complete, I emailed my article to about a dozen senior officials at Treasury and the Service. About three days after that, this issue first appeared on the Treasury-IRS Priority Guidance Plan, where it remained until late 2009—about four and a half years with no visible results—before it was unceremoniously removed—and without explanation.

NSSTA fears the use of the qualified settlement fund because it gives the plaintiffs the opportunity to structure without involvement of the defense. As early as 1997, NSSTA began to discourage the use of the QSF, except in mass torts. It turned to its tax counsel, the law firm of Hogan & Hartson, who came up with the theory that a qualified settlement fund created for a single claimant resulted in that claimant having economic benefit in the funds. In more than one instance Hogan & Hartson claims that some officials at the Service agree with their theory of economic benefit attaching when there is but a single claimant. Details of that effort appear in my *Virginia Tax Review* article, beginning at page 673.

The economic benefit theory being promulgated by the defense is the new canard to replace the old one. You remember: "Knowledge of the cost of the annuity is constructive receipt."

The irony here was that NSSTA's stated mission is to promote the use of structured settlements. But, in this case, it was looking for a way to stop them from being arranged without the defense participation. They were—and still are, in effect, discouraging the use of structured settlements, rather than promoting them.

As soon as NSSTA discovered the request to Treasury in June 2003 by the Society of Settlement Planners for published guidance on the single-claimant issue, it wrote a letter urging that the guidance not be published. NSSTA did not advance any viable tax theory as to why a single claimant should be deemed to have economic benefit. They simply didn't want the guidance to be published. That seems to be their mantra. "Just don't publish the guidance." I note that John Stanton of Hogan & Hartson has submitted written comments for this hearing and is scheduled to appear on behalf of NSSTA. I believe Mr. Stanton has submitted the 2003 NSSTA letter for the record of these proceedings. This is simply another way of saying "Just don't publish the guidance." Mr. Stanton's stated purpose of being here today is to refute my suggestion that the economic benefit issue can be resolved easily in the proposed revision to section 1.104 of the Regulations, on the basis that my suggestion exceeds the scope of the proposed revision. Of course, the scope should be whatever is "needful" in order to clarify Code section 104. I suppose

I should be flattered that NSSTA views me as a threat to disrupting the status quo. I hope that speaks for the credibility of my remarks today.

Now, let's get to the tax issues:

I understand that the branch responsible for this project—Branch 4—has limited the scope of the proposed revision to a couple issues in order to avoid the type of controversy that has stalled this project in the past. But, the scope of this project should be determined by the necessity for guidance related to Tax Code section 104, and not limited for the convenience of the staff. This issue is primarily a Code section 104 issue, and the corresponding Regulation is an appropriate place to clarify how the Code will be interpreted. I sincerely hope that you will recognize the legitimate need to clarify and that the law requires such clarification.

Section 7805(d) of the Code says "[T]he Secretary of the Treasury shall prescribe all needful rules and regulations for the enforcement of this title." [Meaning title 26 of the U.S. Code, of course.] There is simply a duty to the taxpayer constituency—a statutory duty at that—to provide the guidance. This need is compounded by the fact that certain people within this building reportedly have made comments being used by the defense community to promote fear among those who would otherwise employ the qualified settlement fund for the benefit of their clients.

The campaign against the use of the qualified settlement fund has been effective in at least one other regard. Several life insurance company members of NSSTA refuse to accept qualified assignments from 468B funds when there is a single claimant, by their definition, which often includes a family group with competing claims.

I am not asking the Service to develop a new policy to clarify this issue. I submit that the policy is already in existence, except that one must go to several sources to piece it together. The proposed scope of the revision is to incorporate some legislative history dating back to 1996. That's 14 years ago. What about the legislative history from 1982 that never got included in the Regulations? That's 28 years ago, twice as long.

I have elaborated in my earlier written submission on the policy that already exists. That submission is cited as 2009 TNT 192-21. I also covered it in more depth in my Virginia Tax Review article. Here is a summary:

- Revenue Rulings 77-230, 79-220 and 79-313 creating an exception to the constructive receipt and economic benefit doctrines for structured settlements
- Periodic Payment Settlement Tax Act of 1982, which codified the revenue rulings, concurring with the Service
- Technical and Miscellaneous Revenue Act of 1988, allowing security interest in the annuity without causing economic benefit or constructive receipt.
- Victims of Terrorism Tax Relief Act of 2001, confirming congressional intent that the economic benefit doctrine should not be expansively interpreted
- Revenue Ruling 2003-115, providing guidance for a structured settlement with a qualified settlement fund established for the benefit of a single claimant from the 9/11 attack
- *Childs v. Commissioner*, 103 T.C. 634 (1994), *aff'd* 89 F.3d 865 (11th Cir. 1996), providing controlling authority that economic benefit does not attach to any payee in

a structured settlement, so long as the payee has only the rights to the future payments and does not control the qualified funding asset

- PLR 97-36032, favoring four taxpayers who were each sole beneficiaries of identical qualified settlement funds, declaring that there would be no inclusion in their gross income
- PLR 97-03038, allowing periodic payments to a single claimant from a trust acting as an assignee
- PLR 200836019, recognizing the concept of a "non-qualified assignment" and that it can defer current year recognition of income

I urge this panel to consider also the writings of Jeremy Babener, who has submitted his article on the single claimant issue for the record. It is titled "Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History" and it has been accepted for publication in the New York University *Journal of Legislation & Public Policy*. Mr. Babener makes a similar analysis.

The point is that all of these events that I have described above and in detail in my previous submission, as well as in my *Virginia Tax Review* article, demonstrate that Congress, Treasury (including the IRS) and the Courts have spoken on the single claimant issue, confirming that economic benefit does not attach in periodic payment arrangements. The rule distilled from all of these events can be appropriately inserted into the corresponding Regulations for Code section 104. I have previously provided proposed text—one single paragraph—for your consideration.

I understand the workings of bureaucracies, having served as a commander, general's aide and staff officer in the U.S. Air Force and having headed a bureau-level federal agency. I know that there may be a reluctance to take on this issue when Treasury let it languish for more than four years before finally dropping it. But, the need to clarify the single claimant issue still exists, and so does the opportunity to clarify with this revision to the Regulations.

I support the expansion of the scope for other reasons than the economic benefit issue. Attorneys David Higgins and John McCulloch have proposed some thoughtful suggestions for defining what constitutes a "personal physical injury or physical sickness" within the meaning of Code section 104(a)(2).

As a practitioner who has been involved in periodic payment tax issues since 1986, I can attest to the need for published rules on the application of the economic benefit doctrine to amounts received to resolve claims. I urge Treasury and the Service to adopt the text I have proposed and incorporate it into Income Tax Regulations section 1.104.

Please don't forget: You are here to serve the people—not the other way around.

Thank you for this opportunity to speak on the record and for your thoughtful consideration.

A CASE FOR THE URGENT NEED TO CLARIFY TAX TREATMENT OF A QUALIFIED SETTLEMENT FUND CREATED FOR A SINGLE CLAIMANT

Richard B. Risk, Jr.[*]

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"[T]he Secretary of the Treasury shall prescribe all needful rules and regulations for the enforcement of this title [Title 26, U.S. Code].
– I.R.C. § 7805(d)

I. INTRODUCTION

There is a pressing need for the Treasury—through the Internal Revenue Service (Service)—to issue guidance on the tax treatment of an Internal Revenue Code (Code) section 468B designated settlement fund (DSF) or qualified settlement fund (QSF) created for the benefit of a single claimant to facilitate a section 130 "qualified assignment" of a periodic payment liability. Injured claimants routinely are harmed a second time by self-insured entities and liability insurance companies when settlement or judgment terms include periodic payments.[1] The use of a DSF or QSF is effective in removing the adversarial party from involvement in the distribution of the claimant's damage proceeds.[2] However, assertions of potentially adverse tax treatment of the payments to injury victim payees are

[1] *See* Richard B. Risk, Jr., *Structured Settlements: The Ongoing Evolution from a Liability Insurer's Ploy to an Injury Victim's Boon*, 36 TULSA L.J. 865, 887-89 (2001).

[2] *Id.* at 892-901.

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causing victims either to forego tax-free periodic payments altogether or else place themselves at the mercy of the adversary.

If a tort claim for personal physical injury or sickness is resolved through judgment or settlement and the defendant's tort liability is extinguished in exchange for monetary consideration that includes a series of future periodic payments, future lump sums or some combination of the two, it is called a structured settlement.[3] The structured settlement concept is arguably this country's[4] most responsible means of indemnification for victims of physical injury or sickness.[5] While the structured settlement was likely invented in the

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[3] Congress defined the term "structured settlement" in the Victims of Terrorism Tax Relief Act of 2001, Pub. L. 107-134, § 115, 115 Stat. 2427 (2002) (codified at I.R.C. § 5891). Subsection 5891(c)(1) defines a "structured settlement," for purposes of that Code section, as

> an arrangement (A) which is established by (i) suit or agreement for the periodic payments of damages excludable from the gross income of the recipient under section 104(a)(2), or (ii) agreement for the periodic payment of compensation under any workers' compensation law excludable from the gross income of the recipient under section 104(a)(1), and (B) under which the periodic payments are (i) of the character described in subparagraphs (A) and (B) of section 130(c)(2), and (ii) payable by a person who is a party to the suit or agreement or to the workers' compensation claim or by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with section 130.

Id. § 589(c)(1). In reality, this definition is not fully inclusive, as there are structured settlements of taxable damages that are neither excluded under section 104(a) nor assignable under section 130.

[4] The concept has spread to the United Kingdom and Canada. On December 13, 2002, the Australian Federal Parliament passed legislation making tax-free structured settlements available in that country. *See* Press Release, Senator Helen Coonan, Minister for Revenue and Assistant Treasurer, Structured Settlements and Structured Orders (Dec. 13, 2002), *at* http://assistant.treasurer.gov.au/atr/content/pressreleases/2002/130.asp.

[5] A structured settlement's benefits primarily are twofold: (i) it protects against spendthrift behavior by the injury victim; and (ii) it adds the benefit of tax-free growth of the periodic payment funding asset, so long as the payee does not have constructive receipt or economic benefit of the asset. *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999) pt. III, *available at* http://www.house.gov/jct/x-15-99.htm. This is the first time that Congress has issued a statement of public policy pertaining to structured settlements. A lump sum damage payment on account of personal physical injury or physical sickness (except punitive damages) is otherwise excluded from gross income of the taxpayer. Since Code sections 104(a)(1) and (2) refer to payments made either at the time of settlement or over time, the growth of the annuity or Treasury obligation is

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mid-1960s, it first gained legitimacy in the late 1970s when the Service issued three revenue rulings on the tax treatment of periodic payments made to personal injury claimants.[6] However, the concept is tainted by the history of abuses perpetrated against claimants by the liability insurance industry in their quest to create profit centers within their claims departments.

Structured settlements were invented by the defense, and the marketing of the annuities that serve as the underlying assets to fund payments has been tightly controlled. Control was largely accomplished through the creation of the National Structured Settlements Trade Association (NSSTA), which operates as the alter ego of the insurance industry[7] and initially set the standard for how structured settlements were handled.[8] Brokerages, initially comprising primarily former property and casualty (P&C) insurance claims personnel, were organized as the structured settlement marketing distribution system. At the behest of annuity brokerages, life insurance companies affiliated with the liability insurers and unaffiliated life companies joined NSSTA and created barriers to entry. For example, life insurance agents otherwise licensed to sell annuities could not participate. This pattern persists today; structured settlement brokerages are touted as specialists, and insurance agents are prohibited from being appointed to sell structured settlement annuities unless they join one of the brokerages.[9]

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also tax-free. I.R.C. §§ 104(a)(1)-(2).

[6] *See* Rev. Rul. 77-230, 1977-2 C.B. 214; Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75. Congress codified the results of these rulings in the Periodic Payment Settlement Tax Act of 1982. Pub. L. 97-473, § 101, 96 Stat. 2605 (1983) (codified at I.R.C. § 104(a)).

[7] NSSTA voting membership is limited under the group's bylaws to a single representative of each member life insurance company (Provider Member) and of each brokerage (Producer Member). A third influential group, the liability insurance companies (User Members), has no vote but exerts control over the brokerages on their "approved broker" lists and through their affiliated life insurance companies. Most self-insured corporations and liability insurers that have *quid pro quo* arrangements with brokerages to handle the structured settlement aspects of their physical injury liability claims are not members of NSSTA. NSSTA, *Bylaws*, Article II, *in* NSSTA MEMBERSHIP DIRECTORY 2003-2004.

[8] NSSTA's influence has waned with the assertion of plaintiffs' rights to select the broker and annuity provider, but NSSTA still facilitates defense efforts to maintain control. I discuss some of these efforts *infra* in Part III.

[9] In *Weil Insurance Agency v. Manufacturers Life Insurance Co.*, several plaintiff brokers sued several annuity issuers and defense brokerages in federal district court based on their defense-only policy, which denied information on costs of structured settlements to brokers who did business with tort plaintiffs. 815 F. Supp.

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1320 (N.D. Cal. 1992). In upholding summary judgment for the defendants, the Court of Appeals for the Ninth Circuit found that, while exclusion of a competitor may be a prerequisite for finding that a refusal to deal violates antitrust laws, it is not enough to sustain a finding of antitrust injury. *See* Legal Econ. Evaluations, Inc. v. Metro. Life Ins. Co., 39 F.3d 951, 951 (9th Cir. 1994). The court said antitrust laws are concerned about injury to competition, not competitors. *Id.* The appellate court acknowledged the injury that occurs from defense-only brokerages, but said, "Weil's injury does not flow from these competitive harms." *Id.* at 953. The plaintiffs had settled with two of the defendants by the time the appeals court ruling was made. However, the impact of this litigation was positive in that it influenced the life insurance markets to remove restrictions against doing business with plaintiffs.

See also the related case of *Manufacturers Life Insurance Co. v. Superior Court*, 895 P.2d 56, 58 (Cal. 1995). A settlement annuity broker had brought action against a life insurer, other insurers, competing insurance brokers, trade associations, and an officer of a competing brokerage to recover for violations of several state antitrust acts by boycotting the broker's business. The Supreme Court of California, en banc, affirmed the Court of Appeals, holding that (1) the Unfair Insurance Practices Act (UIPA) does not exempt a life insurance company from antitrust laws of the Cartwright Act and unfair business practice laws of the Unfair Competition Act, and (2) a cause of action for unfair competition based on conduct made unlawful by the Cartwright Act is not prohibited by the fact that the UIPA does not create a private civil cause of action.

The barrier to entry remained after *Weil*, as evidenced by a letter addressed to the author from Delphine Evans, Associate, Capital Initiatives (Apr. 9, 1990) (on file with author), in response to the author's inquiry about being appointed by that company to sell its structured settlement products. Typical of the annuity market policy is the text of this letter from Capital Initiatives, which was later absorbed by AEGON Financial Services, Louisville, Ky. (which exited the structured settlement marketplace in 2003). The letter says in part:

> Due to the highly technical and legally complex nature of the structured settlement business, consultants must be able to document their legal and technical expertise in the area of structured settlements. One of the ways Capital Initiatives ensures this expertise is by restricting our licensing to companies that specialize in doing primarily structured settlement business. This approach is designed to avoid unduly exposing Capital Initiatives to the many and significant liabilities associated with the structured settlement business.
>
> In order to ensure that Capital Initiatives provides superior service to our structured settlement consultants, we limit the number of consultants we license. . . .
>
> In order to meet our aggressive production goals and to ensure a mutually beneficial relationship, prospective consultants must be able to document the ability to produce at least $2.5-3.0 million in annual premium with Capital Initiatives.

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Brokerages formed alliances with self-insured defendants and liability insurers for the exclusive right to handle all structured settlement transactions resulting from the resolution of tort claims.[10] Initially, the *quid pro quo* of these alliances, in exchange for the broker's exclusive arrangement, was simply the broker's ability to make the money being offered to resolve the tort claim appear to the claimant to be a much larger amount.[11] In the 1980s, the practice of rebating part of the commission from the annuity sale back to the liability insurer became the marketing plan for many, if not most, structured settlement brokerages.[12]

This lucrative business has grown to more than $6 billion in annual premiums for annuity sales.[13] It is easy to see why those who have controlled this industry for more than two decades—and have become very wealthy in the process—do not wish to give it up.

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[10] See *infra* note 108 and accompanying text for discussions of alliances between brokerages and defendants and their insurers.

[11] The insurers capitalized on the fact that the time value of money apparently is not widely understood by unsophisticated claimants to make the present value or actual cost of the settlement appear larger than it actually was. They and the brokers who worked with them refused to divulge the cost of the annuity, telling the claimants that knowledge of the cost constituted constructive receipt, which caused the loss of tax benefits. This canard was dispelled by two private rulings. Priv. Ltr. Rul. 83-33035 (May 16, 1983) (disclosure by the defendant of the existence, cost, or present value of the annuity will not cause the payee to be in constructive receipt of the present value of the amount invested in the annuity); Priv. Ltr. Rul. 90-17011 (Jan. 24, 1990) (knowledge of the existence, cost and present value of the annuity contract used to fund the settlement offer . . . will not cause the family to be in constructive receipt of the amount payable under the annuity contract or the amount invested in the annuity contract). However, the use of tax treatment uncertainty is still a favorite intimidation weapon of the defense, as will be developed in this article.

[12] It was the proliferation of rebating that prompted the request for a study on its legality conducted by LeBoeuf, Lamb, Leiby & MacRae, of Washington, D.C., and reported in a letter from L. Charles Landgraf, May 3, 1989, "Commission Rebates by Structured Settlement Brokers," to Randy Dyer, Executive Vice President, NSSTA. This report and the failure of the industry to act on it are discussed in greater detail later in this article. *See infra* note 109 and accompanying text.

[13] NSSTA announced that structured settlement annuity premium sales by its members during 2002 reached $6.12 billion. *See* Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003) (on file with author). The universal commission rate for structured settlement annuities is 4 percent, according to the author's experience. Based on $6.12 billion in sales, the total commission paid each year is $244.8 million, including commission withheld from the exclusive brokerages as indirect rebates by some life insurance companies or paid back to their P&C affiliates, as part of an "approved broker list" scheme.

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Congress did not intend for funds held temporarily in a QSF to constitute "economic benefit"[14] to claimants, even if the fund is created for ultimate distribution to a single claimant. Detractors have argued that economic benefit attaches, preventing the qualified assignment from taking place. This also deprives the injury victim of significant tax advantages.

The uncertain tax treatment of a single-claimant QSF is largely the result of internal tension among Treasury and Service officials. Those who enforce the rules, oversee audits, and issue private letter rulings reportedly are at odds with those who interpret the laws and make policy by issuing Treasury Regulations and other controlling directives. Efforts to obtain clarification on the tax treatment of single-claimant QSFs have been crippled by these conflicts within the government.

This article will argue that Congress does not intend for the judicial doctrine of economic benefit to apply to a DSF or QSF[15] created for the benefit of a single claimant. It will also demonstrate why it is appropriate and necessary that Treasury and the Service issue guidance at this time.

II. THE TAX CASE FOR MY ARGUMENT

The technical arguments of congressional intent are straightforward, gleaned from the statutes and their amendments as well as committee reports. Based on these sources, it is apparent that Congress did not intend for the judicial doctrine of economic benefit to apply to the facts of a designated settlement fund or qualified settlement fund created for the benefit of a single claimant.

My analysis begins with the premise that, except as otherwise provided in the Code, gross income means all income from whatever source derived.[16] If there is no exclusion, all monies received from the transferor by the QSF are taxable to the claimant. There can be no qualified assignment.

In order to determine that a QSF may make a qualified assignment to a single claimant within the meaning of section 130(c), I

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[14] Used as a term of art here, the judicially created doctrine of "economic benefit" is discussed *infra* in Part II.B.2.

[15] For purposes of this discussion, references hereafter generally will be to the QSF. However, since they both stem from the authority of Code section 468B, a reference to a QSF will be understood to apply also to a DSF. Exceptions will be made when a reference to a DSF is specifically intended.

[16] I.R.C. § 61(a).

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will show that the QSF's assignments will comply with the requirements of Code sections 104(a)(2), 130, and 468B, as well as Treasury Regulations section 1.468B, and Revenue Procedure 93-34, 1993-2 C.B. 470.[17]

A. Compliance with Section 104(a)(2)

Section 104(a)(2) generally excludes from income the amount of any non-punitive damages received on account of personal physical injuries or physical sickness.[18] The House Report accompanying the Small Business Job Protection Act of 1996, which modified the exclusion of damages by adding the word "physical" before injury and sickness and specified that the exclusion does not apply to punitive damages, created an origin-of-the-claim test:

> If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party. For example, damages (other than punitive damages) received by an individual on account of a claim for loss of consortium due to the physical injury or physical sickness of such individual's spouse are excludable from gross income.[19]

Whether punitive damages were ever pled or discussed is also relevant to determining whether the exclusion from gross income under section 104(a)(2) applies. As the 1995 case of *Bagley v. Commissioner* demonstrates, the Service will not necessarily accept a court's classification of damage.[20] In *Bagley*, a settlement allocated entirely to non-taxable compensatory damages was reallocated to taxable punitive damages. Likewise, in *Amos v. Commissioner*, the

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[17] *See id.* §§ 104(a)(2), 130, 468B; Treas. Reg. § 1.468B (1992); Rev. Proc. 93-34, 1993-2 C.B. 470. Treasury Regulations § 1.104-1, which corresponds to Code section 104(a), offers no substantive additional guidance pertinent to this analysis. Treas. Reg. § 1.104-1 (as amended in 1970). In fact, this section of the Income Tax Regulations has not been updated to incorporate revisions to section 104 resulting from the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605(a)-(c), 110 Stat. 1755 (1996), which taxes punitive damages and damages not attributable to physical injuries or physical sickness.

[18] I.R.C. § 104(a).

[19] H.R. REP. NO. 104-586, at 1 (1996).

[20] 105 T.C. 396 (1995).

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Tax Court reallocated forty percent of non-taxable physical injury damages claimed by the petitioner to taxable non-physical compensation for agreeing to a confidentiality covenant, since the physical injury was not considered extensive enough by the Service or the court to warrant the amount of damages paid by the defendant.[21] In another case, *Barnes v. Commissioner*, the court looked to the record to determine what kind of damages the settlements payments were made in lieu of.[22] If the settlement agreement is silent on the issue, the Service will go to the pleadings and other evidence to determine what motivated the payor to pay the settlement amount.[23] In *Barnes*, there was no specific mention of an allocation between excludable personal injury damages and punitive damages in the settlement agreement. Punitive damages were mentioned in the pleadings and the plaintiff's attorney had mentioned in the negotiations that there was a "likelihood" of punitive damages.[24] The Tax Court held that the damages should be allocated one-half to taxable punitive damages and one-half to excludable personal injury damages.[25] If there is any doubt that punitive damages might become an issue, the settlement documents should be clear that the allocation is not just an accommodation to one of the parties, but an arms-length transaction.

B. Compliance with Section 130

Under section 130(a), any amount received for agreeing to a qualified assignment is not included in gross income to the extent that

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[21] Amos v. Commissioner, 86 T.C.M. (CCH) 663 (2003). During a 1997 professional basketball game between the Chicago Bulls and the Minnesota Timberwolves, Dennis Rodman of the Bulls landed on a group of photographers, causing minor physical injuries to photographer Eugene Amos which were compounded when Rodman kicked Amos in the groin. The parties entered into a "Confidential Settlement Agreement and Release" providing a lump sum payment of $200,000 to the photographer and containing extensive confidentiality provisions for the benefit of Rodman, including the amount paid to Amos. The Service had sent a notice of deficiency to Amos based on all but one dollar being taxable damages. The Tax Court was more sympathetic to Amos, allowing $120,000 for his injuries, but still reallocating $80,000 or forty percent as taxable compensation for the confidentiality aspect of the settlement. The court asserted that the total amount of the settlement was too high to be exclusively for actual physical injuries sustained.

[22] Barnes v. Commissioner, 73 T.C.M. (CCH) 1754, 1756 (1997).

[23] *Id.*

[24] *Id.*

[25] *Id.*

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amount does not exceed the aggregate cost of any qualified funding assets.[26] Section 130(c) defines a "qualified assignment" as any assignment of a liability to make periodic payments as damages, whether by suit or agreement, on account of personal injury or sickness (in a case involving physical injury or sickness) provided certain conditions are met:

> (1) if the assignee assumes such liability from a person who is a party to the suit or agreement, or the workmen's compensation claim, and
> (2) if—
> (A) such periodic payments are fixed and determinable as to amount and time of payment,
> (B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments,
> (C) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and
> (D) such periodic payments are excludable from the gross income of the recipient under paragraph (1) or (2) of section 104(a).[27]

Section 130(d) defines the term "qualified funding asset" to mean any annuity contract issued by a company licensed to do business as an insurance company under the laws of any state, or any obligation of the United States, if:

> (1) such annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment,
> (2) the periods of the payments under the annuity contract or obligation are reasonably related to the periodic payments under the qualified assignment, and the amount of any such payment under the contract or obligation does not exceed the periodic payment to which it relates,
> (3) such annuity contract or obligation is designated by the taxpayer (in such manner as the Secretary shall by regulations prescribe) as being taken into account under this section with respect to such qualified assignment, and
> (4) such annuity contract or obligation is purchased by the taxpayer not more than 60 days before the date of the

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[26] I.R.C. § 130(a).

[27] *Id.* § 130(c).

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> qualified assignment and not later than 60 days after the date of such assignment.[28]

The Periodic Payment Settlement Act of 1982 added section 130 and amended section 104(a)(2) to exclude personal injury damages received as periodic payments from the recipient's gross income, whether by suit or agreement.[29] The new provision of section 104(a)(2) was intended to codify existing law as reflected in Revenue Rulings 77-230, 79-220 and 79-313.[30] References to constructive receipt and economic benefit are not included in either section 104 or 130. However, Congress stated that:

> The periodic payments of personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments.[31]

1. Constructive Receipt

Section 451 provides that "the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period."[32] Section 1.451-1(a) of the Treasury Regulations states that gains, profits, and income are to be included in gross income from the taxable year in which they are actually or constructively received by the taxpayer, unless includable for a different year in accordance with the taxpayer's method of accounting.[33] Under the cash receipts and disbursements method of accounting, such an amount is includable in gross income when actually or constructively received.[34]

Treasury Regulations section 1.451-2(a) provides in part that

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[28] *Id.* § 130(d).

[29] Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, § 104(a), 96 Stat. 2605, 2605 (1983) (codified at I.R.C. § 130).

[30] *See* Rev. Rul. 77-230, 1977-2 C.B. 214; Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.

[31] S. REP. NO. 97-646, at 4 (1982).

[32] I.R.C. § 451.

[33] Treas. Reg. § 1.451-1(a) (as amended in 1999).

[34] *Id.*

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income, although not actually reduced to a taxpayer's possession, is *constructively received* in the taxable year during which it is credited to this account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given.[35] However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.[36]

2. Economic Benefit

The doctrine of "economic benefit" requires a determination that the actual receipt of property or the right to receive property in the future confers a current economic benefit on the recipient.[37] The doctrine applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for a taxpayer's sole benefit.[38]

In *Sproull v. Commissioner*, the court applied the economic benefit doctrine to tax amounts an employer paid to an interest-bearing trust as compensation for an employee's past services.[39] No one other than the employee had any interest in or control over the monies in the trust, and the employee was required to take no further action to earn or establish his rights to the amounts in trust.[40] The trustee's duties were limited to holding, investing, and paying the amounts in trust to the employee or his estate in the event of his prior death in the two taxable years following the creation of the trust.[41] The Tax Court held that "there is no doubt that such an interest had a value equivalent to the amount paid over for his benefit."[42]

The economic benefit doctrine does not apply where the beneficiary's ability to obtain trust amounts is subject to a future condition or forfeiture.[43] The *Sproull* Court noted that "the trust

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[35] Treas. Reg. § 1.451-2(a) (as amended in 1979).

[36] *Id.*

[37] *See* Minor v. United States, 772 F.2d 1472 (9th Cir. 1985).

[38] *See* Sproull v. Commissioner, 16 T.C. 244, 247 (1951); Rev. Rul. 60-31, 1960-1 C.B. 174 (Situation 4).

[39] 16 T.C. 244, 247 (1951).

[40] *Id.*

[41] *Id.*

[42] *Id.* at 248.

[43] Drysdale v. Commissioner, 277 F.2d 413 (6th Cir. 1960) (taxpayer did not have economic benefit of funds placed in trust by employer where the use of funds was conditioned upon taxpayer's death, his reaching the age of sixty-five, or his

agreement contained no restriction whatsoever on petitioner's right to assign or otherwise dispose of the interest, thus created no restriction in him."[44] Other courts have noted that a taxpayer may still have an economic benefit in a trust where there are restrictions on assignment.[45] However, there is no economic benefit when the beneficiary's right to receive the income is restricted or conditioned upon future events.[46] Therefore, in order for a taxpayer to include an amount in income under the economic benefit doctrine, the amount must be set aside irrevocably, for the taxpayer's sole benefit, without restrictions or conditions based upon the occurrence of future events.

Congress has softened its stand on the economic benefit doctrine and whether it renders a periodic payment obligation unassignable under section 130. As initially enacted in 1983, section 130 restricted the rights a claimant has against the assignee and in the assets used to fund future periodic payments.[47] Congress repealed section 130(c)(2)(C) in 1988[48] because, in Congress's view, "[r]ecipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of the tax law."[49]

Congress also provided much greater rights to payees in structured settlements with the enactment of the Victims of Terrorism Tax Relief Act of 2001, which added section 5891 to the Code.[50]

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retirement from full time activity); Minor v. United States, 772 F.2d 1472 (9th Cir. 1985) (taxpayer did not have economic benefit in funds placed in trust under deferred compensation agreement where funds were conditioned upon taxpayer's limiting his practice after retirement and not competing with present employer).

[44] 16 T.C. at 248.

[45] *See* United States v. Drescher, 179 F.2d 863 (2d Cir. 1950) (employee received economic benefit of annuity contract purchased by employer in the year such contract was delivered to him, even though such contract was non-assignable).

[46] *See Minor*, 772 F.2d at 1475-76.

[47] *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101, 96 Stat. 2605, 2605-2606 (1983) (codified at I.R.C. § 130).

[48] I.R.C. § 130(c)(2)(C) (repealed 1988). Public Law 100-647, section 6079(b)(1)(A), deleted Code section 130 subparagraph (c)(2)(C) and redesignated subparagraphs (c)(2)(D) and (c)(2)(E) as subparagraphs (c)(2)(C) and (c)(2)(D). Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A), 102 Stat. 3342, 3710 (1988). The deleted subsection read as follows: "(C) the assignee does not provide to the recipient of such payments rights against the assignee which are greater than those of a general creditor." 26 U.S.C.A § 130 History, Ancillary Laws and Directives (1999).

[49] H.R. REP. NO. 100-795, at 541 (1988).

[50] *See* Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, 115 Stat. 2427 (codified at I.R.C. § 5891).

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Section 5891 regulates factoring transactions by imposing a forty percent federal tax on the factoring discount unless approved in advance by an applicable state court.[51] This section also gives payees the ability to transfer structured settlement payment rights (including portions of structured settlement payments) made for consideration by means of sale, assignment, pledge, or other form of encumbrance or alienation for consideration.[52] These new rights go far beyond those of the payee in Revenue Ruling 79-220. Under that ruling, the payee could receive only the monthly payments—he could not have the actual or constructive receipt or the economic benefit of the lump sum that was invested to yield that monthly payment.[53]

The developments following the codification of Revenue Ruling 79-220 in the Periodic Payment Settlement Tax Act of 1982 indicate that a more lenient interpretation of constructive receipt and economic benefit is appropriate for structured settlements. The definitions of constructive receipt and economic benefit are to be construed much more narrowly when applied to structured settlements than to other deferred compensation situations when congressional intent is considered.

C. Initial Qualification Under Treasury Regulations § 1.468B and Compliance with Revenue Procedure 93-34

Treasury Regulations section 1.468B-1(a) provides that a QSF is a fund, account, or trust that satisfies all the requirements of section 1.468B-1(c).[54] Section 1.468B-1(c) generally provides that the fund, account, or trust is a QSF if: (1) it is established pursuant to an order of, or is approved by, a court of the United States or any state (including the District of Columbia) and is subject to the continuing jurisdiction of that authority; (2) it "is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability arising" out of tort, breach of contract, or violation of law; and (3) the "fund, account, or trust must be a trust under applicable state law, or its assets must be otherwise segregated from other assets of the

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[51] I.R.C. § 5891(a).

[52] *Id.* § 5891(c)(3)(A).

[53] Rev. Rul. 79-220, 1979-2 C.B. 74. Revenue Ruling 79-220 is discussed in more detail later in this article. *See infra* Part II.D.

[54] Treas. Reg. § 1.468B-1(a) (as amended in 1993).

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transferor (and related persons)."[55]

Under Revenue Procedure 93-34, a DSF described in Code section 468B(d)(2) or a QSF described in Treasury Regulations section 1.468B-1 will be considered "a party to the suit or agreement" for purposes of Code section 130 if each of the following requirements is satisfied:

> (1) the claimant agrees in writing to the assignee's assumption of the designated or qualified settlement fund's obligation to make periodic payments to the claimant;
> (2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) . . .;
> (3) each qualified funding asset purchased by the assignee in connection with the assignment by the designated or qualified settlement fund relates to a liability to a single claimant to make periodic payments for damages;
> (4) the assignee is not related to the transferor (or transferors) to the designated or qualified settlement fund within the meaning of sections 267(b) or 707(b)(1); and
> (5) the assignee is neither controlled by, nor controls, directly or indirectly, the designated or qualified settlement fund.[56]

If these requirements are satisfied, and if the requirements of section 130 are satisfied, then the assignment is a qualified assignment within the meaning of section 130 and the transferor to the QSF will not be treated as receiving a deemed distribution from the fund to the transferor when the qualified assignment is made. If, based on the documents reviewed, representations made and information provided, the settlement qualifies as a QSF and will continue to qualify as long as it is administered under the terms of the QSF agreement approved by the court, the settlement may make a qualified assignment of the periodic payment obligation under the provisions of Code section 130, even if the QSF is created for the benefit of a single claimant.[57]

D. Structured Settlements Are Specifically Carved Out of the Economic Benefit Rule

Congress created an exception to the broad rule established by

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[55] *Id.* § 1.468B-1(c).

[56] Rev. Proc. 93-34, 1993-2 C.B. 470.

[57] *See id.*

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case law defining economic benefit as applied to structured settlements.[58] Revenue Ruling 79-220 was one of three key rulings that were later codified by the Periodic Payment Settlement Tax Act of 1982.[59] The facts of that ruling were as follows:

> [T]here is a continuing obligation by *M* to $250 per month to *A* for the agreed period. *M*'s purchase of a single premium annuity contract from the other insurance company was merely an investment by *M* to provide a source of funds for *M* to satisfy its obligation to *A*. See Rev. Rul 72-25, 1972-1 C.B. 127, which relates to a similar arrangement made by an employer to provide for payment of deferred compensation to an employee. In Rev. Rul. 72-25, as here, the arrangement was merely a matter of convenience to the obligor and did not give the recipient any right in the annuity itself.[60]

On these facts, the Service held:

> The exclusion from gross income provided by section 104(a)(2) of the [Internal Revenue Code of 1954] applies to the full amount of the monthly payments received by *A* in settlement of the damage suit because *A had a right to receive only the monthly payments and did not have the actual or constructive receipt or the economic benefit of the lump-sum that was invested to yield that monthly payment.* If *A* should die before the end of 20 years, the payments made to *A*'s estate under the settlement agreement are also excludable from income under section 104.[61]

Under the facts of Revenue Ruling 79-220, the single premium immediate annuity purchased by *M* as a convenience to *M* to fund its obligation to *A* is an amount set aside irrevocably for *A*'s sole benefit.[62] Economic benefit applies, according to *Sproull*, when assets are unconditionally and irrevocably paid into a fund or trust to be used for a taxpayer's sole benefit.[63] However, as in *Sproull*, the deciding factor in Revenue Ruling 79-220 was control. Sproull alone

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[58] H.R. REP. NO. 97-832, pt. II, at n.2 & Explanation of Provisions (1982).

[59] *Id.*

[60] Rev. Rul. 79-220, 1979-2 C.B. 74.

[61] *Id.* (emphasis added).

[62] *Id.*

[63] Sproull v. Commissioner, 16 T.C. 244, 247-48 (1951).

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had an interest in or control over the monies in the trust and was therefore required to take no further action to earn or establish his rights to the amounts in trust.[64] *A*, in contrast, had a right to receive only the monthly payments and thus had no right or control over the annuity. *A* was a single claimant.[65]

In the House of Representatives Report accompanying the Periodic Payment Settlement Tax Act of 1982, the Committee on Ways and Means summarized the present law pertinent to this issue in its "Explanation of the Bill," as follows:

> Rev. Rul. 79-220 holds that where the insurer of a tortfeasor purchases and retains exclusive ownership of a single-premium annuity contract to fund specified monthly payments for a fixed period pursuant to settlement of a damage suit for personal injuries, the recipient may exclude from his or her gross income the full amount of the payments, and not merely the discounted present value. *The taxpayer's only right with respect to the amount invested was to receive the monthly payments, and the ruling concluded that the taxpayer did not have actual or constructive receipt or economic benefit of the amount invested.* [66]

The same report, under reasons for change, clarified that Congress was accepting the Service's decision on the underlying facts of Revenue Ruling 79-220. It agreed with the Service that neither actual or constructive receipt nor economic benefit of the amount invested was triggered. The Report explained that

> [t]he bill specifically provides that the Code section 104 exclusion from gross income of damages for personal injuries or sickness applies whether the damages are paid as lump sums or as periodic payments. *This provision is intended to codify, rather than change, present law.* Thus, the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the current economic benefit of the sum required to produce the periodic payments. [67]

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[64] *Id.* at 248.

[65] Rev. Rul. 79-220, 1979-2 C.B. 74.

[66] H.R. REP. NO. 97-832, pt. II, at n.2 (1982) (emphasis added).

[67] *Id.* at pt. II (emphasis added). The pertinent text is identical in the Senate

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Thus, Congress expressed its intent that, in structured settlements, the judicial doctrine of economic benefit does not apply simply because a sum is set aside irrevocably for the payee's sole benefit—even if the payee is the only claimant who will benefit from the sum set aside. Certainly, Congress intended a bright line distinction in that economic benefit attaches only when the claimant is given control over the sum. Now that Congress has spoken on the issue by adopting the Service's interpretation as its own, neither Treasury nor the Service may override it.

When a sum is deposited into a QSF, the claimant is even further removed from benefit than *A* had been in the Revenue Ruling 79-220 scenario, where *A* was entitled to periodic payments generated by the annuity. When funds initially are deposited into a QSF, the claimant has no right either to that sum or to any periodic payments, because the tort claim held against the QSF has not been settled. Typically, a court having jurisdiction over the claim creates a QSF for the resolution of a physical injury or physical sickness claim.[68] The court continues its oversight over the QSF until the fund is terminated. When the sum is transferred into the QSF, the original defendant is dismissed. However, the cause must remain alive in order for the court to maintain its jurisdiction. This is accomplished by transferring tort liability to the QSF through a novation.[69] Thus, the claimant still has a property right—the tort claim—but has no right to receive any payment from the QSF. At this stage, the claimant agrees only that the amount deposited into the QSF will sufficiently settle the claim, allowing release and dismissal of the tortfeasor.

The QSF then enters into a settlement agreement with the claimant, the terms of which typically include a lump sum payment to cover costs, expenses, liens, immediate needs, a cash reserve, and attorney fees. Terms can also include periodic payments, and any

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version of the report to accompany H.R. 5470. S. REP. NO. 97-646, at 4 (1982)

[68] A QSF must be "established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority." Treas. Reg. § 1.468B-1(c)(1) (1993). This is broader than the Code, which says simply that a DSF (which covers the term QSF) means any fund "which is established pursuant to a court order and which extinguishes completely the taxpayer's tort liability . . . ." I.R.C. § 468B(d)(2)(A).

[69] A novation has the effect of adding a new party as substitute obligor who was not a party to the original duty, and discharging the original defendant by agreement of all parties, completely extinguishing any alleged liability of the defendant. *See* RESTATEMENT (SECOND) OF CONTRACTS § 280 (1981).

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income to the QSF is taxed to the QSF at the highest rate.[70] Revenue Procedure 93-34 allows the QSF to stand in the shoes of the original "party to the suit or agreement" to make a qualified assignment under section 130.[71] At that time, the cash lump sum is disbursed to the payee for actual receipt. The amount to fund the periodic payments is paid to a third-party assignee that, in turn, purchases the qualified funding asset (typically an annuity). In this process, the claimant never controls any of the funds deposited into the QSF, nor are the funds ever held in the QSF for the sole benefit of the payee. Again, this distinguishes the QSF from the Revenue Ruling 79-220 facts because the claimant in that ruling was given a right to receive payments from the annuity's assets, which were being held for the sole benefit of the claimant.[72] In a QSF, there is an even greater distance between the claimant and the amount being held in the QSF than under the Revenue Ruling 79-220 facts.

The selection of the QSF administrator typically is subject to the approval of the claimant. However, the QSF administrator's duty is to the QSF, to ensure that all liabilities of the QSF are extinguished by the time the assets of the QSF are depleted. The relationship between the claimant and the QSF is technically adversarial, although usually much less so than the relationship between the original parties or between the claimant and the tortfeasor's insurer. In any case, the claimant possesses no control over the QSF's assets—they are under the control of the QSF administrator and the court.

1. Single Claimant or Pre-Allocation Triggers of Economic Benefit Result in an Absurdity and Conflict with Canons of Professional Conduct

The assertion that there can be no allocation of the damage recovery amount among the claimants prior to the QSF being funded produces an absurd result. Under this theory, an allocation gives the individual the economic benefit of her portion of the damage recovery. Yet, every case requires an allocation before distribution occurs. Whether allocation occurs before the QSF is established or seconds before disbursement of funds, under this theory, economic benefit triggers. This means no QSF could ever originate a qualified

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[70] Treas. Reg. § 1468B-2(a) (1993) ("A qualified settlement fund is a United States person and is subject to tax on its modified gross income for any taxable year at a rate equal to the maximum rate in effect for that taxable year under section 1(e).").

[71] Rev. Proc. 93-34, 1993-28 I.R.B. 49.

[72] Rev. Rul. 79-220, 1979-2 C.B. 74.

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assignment—even when the QSF is established for the benefit of multiple claimants. Congress obviously did not intend this result.

The allocation theory discussed above also conflicts with the American Bar Association Model Rules of Professional Conduct.[73] Rule 1.8(g) states:

> A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients . . . unless each client consents after consultation, including disclosure of the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.[74]

The older American Bar Association Model Code of Professional Responsibility Disciplinary Rule DR 5-106(A) is essentially the same:

> A lawyer who represents two or more clients shall not make or participate in the making of an aggregate settlement of the claims of or against his clients, unless each client has consented by to the settlement after being advised of the existence and nature of all the claims involved in the proposed settlement, of the total amount of the settlement, and of the participation of each person in the settlement.[75]

Under allocation theory, economic benefit occurs if a global settlement amount offered for the benefit of multiple plaintiffs is allocated before the money is paid into a QSF or at any time before the money is distributed. However, if the attorney is to avoid a professional liability claim for violating the ethics standard applicable to her jurisdiction, all settling parties must be informed of their individual share before the offer is accepted. Nevertheless, this has not kept some attorneys from writing tax opinion letters that contravene both of these conclusions.

2. Unavoidable Single-Claimant Situations Should Not Cause Economic Benefit

Attributing economic benefit in section 130 assignment cases with a single claimant denies the benefit of tax-free periodic payments to

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[73] *See* Burrow v. Arce, 997 S.W.2d 229 (Tex. 1999) (adopting fee forfeiture as a remedy and remanding for trial the issue of whether the rule was violated).

[74] MODEL RULES OF PROF'L CONDUCT R. 1.8(g) (2002).

[75] MODEL CODE OF PROF'L RESPONSIBILITY, DR 5-106(A) (1980).

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certain types of claimants simply because the victim is unavoidably in single-claimant circumstances. It is doubtful that Congress intended this result, considering its stated position that the origin of the claim is the determining factor for eligibility, not the recipient of the physical injury.[76]

Section 468B allows a defendant in a mass tort case to settle before all the plaintiffs have been identified.[77] As an example of the potential injury wrought by the economic benefit theory, suppose an explosion and fire in a building where the number of occupants at the time of the accident cannot immediately be determined.[78] If only one body is recovered and the spouse brings suit on a negligence theory against the building owner, the court may be petitioned to establish a QSF in case more victims are later identified. If granted, the creation of the QSF releases the defendant from the tort liability to all victims because the QSF is substituted for the building owner under a novation. Thus, the QSF assumes all liability for the damages caused by the explosion and fire. If no more victims are identified, the entire fund assets may be paid to only one claimant. Certainly, the drafters of section 468B never intended to condition the availability of tax benefits on the existence of more than one victim.

Another potentially unjust single-claimant situation exists when state probate law requires that the estate's personal representative bring all claims in wrongful death cases on behalf of the estate. This representative is a single claimant, even though numerous heirs of the decedent might be in the position to receive distributions of any damage recover from the estate. It would have been quite anomalous for Congress to have intended section 468B to preclude the heirs in these situations from receiving the tax benefits of a structured settlement. Yet, those who maintain that the creation of a QSF for a single claimant automatically triggers economic benefit would do exactly that.

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[76] *See* H.R. REP. NO. 104-586, at 23 (1996) ("If an action has its origin in a physical injury or physical sickness, then all damages (other than punitive damages) that flow therefrom are treated as payments received on account of physical injury or physical sickness whether or not the recipient of the damages is the injured party.").

[77] I.R.C. § 468B.

[78] A recent example is the terrorist attack on the World Trade Center on September 11, 2001. Although it was certain that there was more than one victim, the exact number of people who perished was unknown for a long time. An explosion and fire in a smaller, largely vacant building might create a situation where only one victim could be initially identified, but the possibility of additional victims could not be ruled out for some time.

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3. Code Section 468B Was Not Created Exclusively for Mass Tort Cases

Prior to a 1988 amendment of section 468B, court-controlled class action settlement funds were not subject to tax at the fund level.[79] Instead, individual claimants were subject to income tax on their respective shares of fund earnings, when such earnings were paid to them. A provision taxing income earned by such funds had been included in the Tax Reform Act of 1986 but was omitted from the Code. Section 1810(f)(5)(A) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA) added section 468B(g), which clarified Congress's intent to subject a settlement fund to current taxation regardless of whether a DSF election was made.[80]

Nothing in the legislative history of section 468B suggests that settlement funds were to be used exclusively for multiple-claim cases, that there needed to be a specific reason for the fund's creation, or that there was a specified minimum duration period for a fund's existence.[81] Yet opponents of the use of the QSF for single-claimant cases regularly assert all of these conditions.[82]

4. The Structured Settlement Carve-Out Does Not Apply to Other Deferred Compensation

Treasury and the Service need not be concerned that a narrow interpretation of the judicially created economic benefit doctrine for structured settlements establishes precedent for the narrowing of economic benefit when applied to other deferred compensation situations. The basic economic benefit doctrine is unchanged.[83]

As noted earlier, Congress has expressly noted on at least three occasions that economic benefit does not attach in structured settlement situations as easily as it might attach in other types of deferred compensation agreements. Court decisions in this area

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[79] I.R.C. § 468B.

[80] *See Taxation and Reporting of Qualified Settlement Funds*, TAX ADVISER (Am. Inst. of CPAs Inc., New York, N.Y.) (Apr. 1, 1996).

[81] *See generally* Donald B. Zief & William P. Van Saders, *Has "Homeless Income" Finally Found a Home?*, 67 TAXES 450, 453 (1989).

[82] *See, e.g.*, ALLSTATE, STRUCTURED SETTLEMENT REPORT (August 1, 1988).

[83] The internal opposition at the Service, according to oral reports given to the author, has come largely from staff members who work in the area of employee benefits. They fear that creating any exception to the economic benefit doctrine might weaken the Service's position toward deferred compensation agreements like the one in *Sproull v. Commissioner*, 16 T.C. 244 (1951), and other court decisions of that ilk.

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likewise suggest that a narrow interpretation of economic benefit is appropriate in the case of structured settlements. In *Childs v. Commissioner,* the Tax Court rejected the Service's position that the right of attorneys to receive periodic payments on behalf of their clients, in satisfaction of the clients' debt for attorney fees, was funded or secured.[84] The court held that the cost of the annuity contract funding the structured settlements received by the taxpayers in satisfaction of attorney's fees represented mere "unfunded promises," and did not constitute "property" under section 83.[85] Therefore, it was not taxable in the year of purchase. The issue appealed by the Service to the Eleventh Circuit was whether the purchase price of the annuities constitutes "property" per Code section 83 and, if so, whether that "property" was transferred.[86] The circuit court rejected the Service's position and upheld the Tax Court ruling.[87]

While the decision in *Childs* broadened the class of payees covered under structured settlements to include attorneys, it leaves intact the requirement that the periodic payments must result from a judgment or settlement where the payments to the claimant are on account of a personal physical injury or sickness within the meaning of section 104(a)(2). Congressional expression of the fact that economic benefit does not attach in structured settlement situations and the *Childs* decision take place in the context of periodic payments for section 104(a)(2) damages. The basic economic doctrine remains intact if Treasury and the Service issue the written guidance requested on whether a QSF established for the benefit of a single claimant may make a qualified assignment within the meaning of section 130. This is a carve-out that provides exceptions to the broad rule. The difference between structured settlements and other garden-variety deferred compensation agreements is easily distinguishable.

E. Summary

Congress has shown that it did not intend the judicial doctrine of economic benefit to apply to a designated settlement fund or qualified settlement fund created for the benefit of a single claimant. The single claimant would not have access to the amount transferred into the QSF because it is: (1) controlled by the QSF administrator, who is independent of the claimant; (2) subject to the continuing jurisdiction

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[84] 103 T.C. 634 (1994), *aff'd* 89 F.3d 865 (11th Cir. 1996).

[85] 103 T.C. at 635.

[86] *Id.*

[87] Childs v. Commissioner, 89 F.3d 865, 865 (11th Cir. 1996).

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of a court or other governmental agency; and (3) not even dedicated to the claimant's benefit until a settlement agreement between the claimant and the QSF is executed. Revenue Ruling 79-220 held that when funds or an asset (annuity) are held for the benefit of a claimant (a single claimant under those facts) to provide periodic payments, and the claimant has no control over those funds, the claimant does not have constructive receipt or economic benefit of those funds.[88] Under the facts of Revenue Ruling 79-220, the claimant was entitled to receive periodic payments generated by the assets being held for the claimant's benefit. Where the assets are simply being held in the QSF, the claimant rights has no rights to future payments until a settlement agreement is executed.[89] This creates additional distance between the funds and the claimant that did not exist in the facts of Revenue Ruling 79-220, strengthening the argument that there is no economic benefit.

Congress specifically agreed, through the legislative history of both the House and Senate for the Periodic Payment Settlement Tax Act of 1982, with the Service's interpretation and findings in Revenue Ruling 79-220. It accepted that neither constructive receipt nor economic benefit should apply when the single claimant had no control over the funds being held for his benefit.[90] Congress expressly stated that it was codifying the existing law.[91]

The congressional intent in the Periodic Payment Settlement Tax Act of 1982 is clear and unambiguous. Allocation theory, which turns every QSF claimant into a single claimant at the instant there is an allocation of the QSF's assets, results in absurdity. It renders all QSFs unable to make a qualified assignment, and is in conflict with the ABA Model Rule of Professional Conduct 1.8(g) and the ABA Model Code of Professional Responsibility's Disciplinary Rule 5-106(A).[92] Moreover, certain situations result in unavoidable single claimants, and Congress never intended to exclude them.

Congress has indicated through subsequent legislation, such as the Technical and Miscellaneous Revenue Act of 1988 and the Victims of Terrorism Tax Relief Act of 2001, that the economic benefit doctrine

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[88] Rev. Rul. 79-220, 1979-2 C.B. 74.

[89] *Id.*

[90] *See* Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 976-473, 96 Stat. 2605 (1983) (codified at I.R.C. § 104(a)); H.R. CONF. REP. NO. 97-984 (1982); H.R. REP. NO. 97-832, pt. II, n.2 (1982); S. REP. 97-646, pt. II, n.2 (1982).

[91] H.R. REP. NO. 97-832, pt. II, Explanation of Provisions (1982).

[92] *See* MODEL RULES OF PROF'L CONDUCT R. 1.8(g) (2002); MODEL CODE OF PROF'L RESPONSIBILITY DR 5-106 (1981).

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should not be expansively interpreted. The narrower definition of economic benefit provides the claimant some rights for the payee in the funding asset itself that *Sproull* and successive case law has not allowed in defining the broad rules of the economic benefit.[93] Decisions by the courts also suggest a narrower definition of economic benefit in the case of structured settlements. The Tax Court's decision in *Childs*, as affirmed by the Eleventh Circuit, confirms that the economic benefit doctrine does not apply even to attorneys who collect all or part of their attorney fees in periodic payments from clients entitled to damages excluded under section 104(a)(2).[94] Congressional action and the decision in *Childs* provide controlling authority that economic benefit does not attach to any payee in a structured settlement, so long as the payee has only the rights to the future payments and does not control the qualified funding asset. The claimant may, however, have a right to a security interest in the funding asset, and he may sell, assign, pledge, encumber by some other form, or alienate by consideration the future payments.

III. THE CASE FOR TREASURY TO ACT IMMEDIATELY

Assuming that a qualified assignment can be made from a single-claimant QSF, the important matter is whether Treasury and the Service will provide written guidance. I argue that the Secretary of the Treasury is obligated to issue written guidance on this matter.

To put this discussion in perspective, one needs to understand (1) the rampant tortious and possibly illegal conduct that exists today in the structured settlement industry; (2) the public policy that is violated in the course of this conduct; (3) the false doubts created by the property and casualty (P&C) companies and those who collaborate with them to perpetuate the illegal and tortious activity; and, (4) the anxiety and uncertainty created in the public by the mixed signals emanating from Treasury and the Service.[95]

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[93] *See* Sproull v. Commissioner, 16 T.C. 244 (1951).

[94] I.R.C. § 104(a)(2); Childs v. Commissioner, 103 T.C. 634 (1994), *aff'd*, 89 F.3d 856 (11th Cir. 1996).

[95] These issues were not presented to Treasury and the Service by Skadden, Arps, Slate Meagher & Flom. *See* Letter from Fred Goldberg, Kenneth Gideon, and Jody Brewster, Partners and Counsel, respectively, Skadden, Arps, Slate, Meagher & Flom, to Pamela F. Olson, Assistant Secretary for Tax Policy, Department of Treasury, and B. John Williams, Chief Counsel, Internal Revenue Service (June 19, 2003) (on file with author and in the public domain). They were, however, presented in a separate communication by the author. *See* Letter from Richard B. Risk, Jr., Attorney and Counselor at Law, Oct. 27, 2003) (on file with author and in the public

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While these factors are not technical tax issues, they certainly bear on whether "needful" guidance is lacking and on the urgency of such guidance.[96] These factors are not offered as an *ad hominem* attack intended to appeal to personal prejudices instead of reason. Deciding the technical tax issue (whether economic benefit attaches) should be done wholly on the merits of the arguments, and the arguments are abundantly clear that economic benefit does not attach to funds transferred to a QSF. However, deciding whether or not to issue guidance is a tax issue—though not a technical one—which must be decided in the context of the Treasury Secretary's duty to act and in consideration of broader public policy established by Congress. A decision not to act is still a decision. All of the ugly factors described here are tax issues because they relate directly to the need for publication of tax treatment guidance.

A. Injury Victims Are Injured Again When Fraud Is Committed on Them

The P&C insurance industry and the brokers who make exclusive "approved broker" deals do so to perpetuate their control over structured settlement transactions. For too long, P&C companies and their brokers have taken the unsupportable position that, as long as the claimant is provided the benefits promised during settlement negotiations, there is no issue if the cost of the periodic payments is less than what was represented due to undisclosed rebating or shopping that takes place after the settlement terms are agreed upon. They appear to have reckoned that because these practices are widespread, they are acceptable.

In two recent decisions, *Lyons v. Medical Malpractice Insurance Association*[97] and *Macomber v. Travelers Property and Casualty Corp.*, courts have come out the other way.[98] In *Macomber*, the Connecticut Supreme Court described this kind of conduct as a "rebating scheme"

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domain).

[96] *See* I.R.C. § 7805(a) (stating that the Secretary "shall prescribe all needful rules and regulations for the enforcement of this title").

[97] 730 N.Y.S.2d 345 (N.Y. App. Div. 2001) (finding privity between settlement parties and remanding for determination of whether insurer's representation of present value constituted fraudulent, intentional or negligent misrepresentation).

[98] 804 A.2d 180 (Conn. 2002) (finding legally cognizable loss from "rebating" and "short changing" schemes); *see also* Matthew Garretson, *A Fine Line We Walk*, 2 ASS'N TRIAL LAWS AM. ANN. CONVENTION REFERENCE MATERIALS: ETHICS IN STRUCTURED SETTLEMENTS 1905 (July 2003) (discussing *Macomber*). Garretson also discusses *Lyons*. *Id.*

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and a "short-changing scheme."[99] The *Macomber* case will no doubt have an effect on structured settlement practices by P&C companies in Connecticut and beyond.

The extent of rebating by structured settlement brokers is unabashedly broad, as the president and CEO of the largest structured settlement brokerage, Robert Blattenburg of Ringler Associates, Inc. stated in a recent letter:

> It is interesting to note that these types of commission sharing or reduced commission agreements are routine in the structured settlement industry. A significant number of the large casualty carriers, self insured's [*sic.*] and insurance agencies have or have had these types of arrangements. Likewise, the majority, if not all of the national structured settlement firms are parties to these types of agreements, including EPS, SFA, Cambridge Galaher, Pension Company, Settlement Planning, American Settlements, Diversified Settlements, Financial Settlements, Brant-Hickey Associates, Settlement Associates, and The Alliance. Last year these firms along with Ringler accounted for in excess of 70% of the structures arranged by independent brokers.[100]

The above letter was written before the Connecticut Supreme Court's *Macomber* decision. No brokerage besides Travelers was a defendant in *Macomber*.

Ringler Associates accounted for approximately $1.6 billion in structured settlement annuity premiums in 2001—nearly twenty-seven percent of the entire $6.12 billion generated in the U.S. by members of NSSTA.[101] Ringler's marketing plan relies heavily on the rebating scheme its president commented on. When a liability insurer or self-insured entity enters an agreement with a brokerage like Ringler, the relationship is called a "national account" or "national program."[102]

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[99] *Macomber*, 804 A.2d at 186.

[100] Letter from Robert J. Blattenberg, President and Chief Executive Officer, Ringler Assocs., to Thomas McCormack, Vice President, National Claims, Chubb & Sons, Inc. (June 25, 2002) (on file with author).

[101] E-mail from Stan Harlan, President, Summit Settlement Services, Re: Survey of standings of industry firms (Mar. 17, 2004) (on file with author); *see also* NSSTA PRESIDENT'S REPORT: "CONTINUED SUCCESS AND GROWTH FOR STRUCTURED SETTLEMENTS" (Apr. 1, 2003), *at* http://www.nssta.com (last visited Feb. 26, 2004) (noting that association members wrote approximately $6.15 billion in premiums in 2002 to cover structured settlement payments).

[102] *See, e.g.*, RINGLER ASSOCS., STRUCTURED SETTLEMENT SERVS. AGREEMENT

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These relationships are monitored centrally and a list showing the amount of the rebate and which other brokerages have relationships with the same entity is provided to each Ringler structured settlement specialist.[103] Brokerages on the list are called "approved brokers." These relationships are designed to prevent a structured settlement specialist engaged by the plaintiff or the plaintiff's attorney from being able to handle the annuity sale transaction.

P&C company and self-insured control over the structured settlement process does not stop with the brokerages. These entities also maintain an "approved market list" of life insurance companies that the P&C company or self-insured defendant will allow to be purchased as the funding asset for a structured settlement. In most cases, the periodic payment liability is transferred by novation to a third-party affiliate of the issuing life insurance company (the assignee), through a section 130 qualified assignment.[104] When this occurs, the injury victim (as ultimate consumer/payee) assumes the risk of assignee default, not the assigning defendant or insurer. This suggests that approved lists of annuity companies are maintained for reasons other than the protection of the defendant or its liability insurer or even for protection of the claimant, to whom the defendant or liability insurer owe no duty.[105] This "approved market list"

(Apr. 17, 1997) (providing for a substantial rebate of Ringler's commission from annuities structured for Prudential and its subsidiaries and affiliates). Typical of such agreements is the *Structured Settlement Services Agreement* dated April 17, 1997, which Ringler entered into with several Prudential entities, calling for a rebate of 1.25% of the premium that will be paid in commissions on the annuity sales. Ringler retains 2.75% of the four percent total commission on the annuity when a Prudential liability insurance case is structured. Four percent is the industry standard for structured settlement annuity commissions.

[103] *See* RINGLER ASSOCS., MASTER LIST OF NAT'L PROGRAM OF MKT. RELATIONSHIPS (excerpt from list on file with author).

[104] *See* I.R.C. § 130.

[105] *See Macomber v. Travelers Prop. and Cas. Corp.*, 804 A.2d 180, 193 n.12 (Conn. 2002). The note states:

> The plaintiffs alleged, specifically, that the defendants acted as the plaintiffs' agents at all times relevant to the settlement of their claims and, as such, owed them a fiduciary duty. We disagree with the plaintiffs' characterization of their relationship with the defendants, and thus look for some other basis upon which to ground their claim for breach of a fiduciary duty.

Id. The note then expands on this finding and suggests that plaintiff control over the annuity purchase would have prevented the wrongdoing alleged:

> After negotiating at arm's length to reach a settlement, the plaintiffs agreed

network is designed to control who gets the annuity premium and who gets the commission.[106] Companies such as CNA, Allstate, Hartford, Liberty, SAFECO, St. Paul, State Farm, Travelers and USAA have announced their intention to recapture damage dollars as annuity premium for their affiliate life insurance companies.[107]

NSSTA had the opportunity to take a stand against rebating when a 1989 study it commissioned from LeBoeuf, Lamb, Leiby & MacRae, L.L.P. (LeBoeuf) warned that certain commission sharing practices practiced by structured settlement brokers possibly violated anti-rebating laws.[108] The LeBoeuf study also noted:

> to accept, and the defendants agreed to provide, part of the total settlement amount in the form of an annuity. Once such an agreement had been reached, the parties' rights and responsibilities were defined by the terms of the settlements alone. Thereunder, the defendants undertook a contractual obligation only to purchase the annuities at a certain cost and with a certain value; the plaintiffs, more importantly, retained no authority over the manner in which the annuities would be procured. Thus, the plaintiffs had no say regarding the type of annuity that would be used to fund their settlements; who would supply the annuity; or the terms under which the annuity was purchased. Indeed, had the plaintiffs been invested with the type of control inherent in the traditional principal-agent relationship, they would have been able to monitor the defendants' conduct and, perhaps, would have been better equipped to safeguard their interests against the rebating and short-changing schemes alleged in the present complaint.

Id.

[106] *See infra* note 108 and accompanying text.

[107] *See* Therese Rutkowski, *Allstate Saves Millions with Six Sigma*, AM. BANKER-BOND BUYER, Apr. 2003, at 16 (discussing Allstate's intention to recapture damage dollars as annuity premium through use of affiliates); Memorandum from Charles W. Harlan, Asst. Vice President, Structured Settlements, CNA, to Ringler Assocs. et al. (Mar. 7, 2003) (discussing funding relationships) (facsimile on file with author) (the author has since learned that CNA Life is being sold, removing the affiliate relationship from CNA P&C); Letter from Kevin A. Mack, Shareholder and Former Officer, Travelers Prop. & Cas. Corp., to Richard Blumenthal, Attorney General, State of Connecticut et al. (Feb. 16, 1998) (alleging improper rebating practices) (copy of letter on file with author); Memorandum from Steve Hatch, Asst. Vice President, Prop. & Cas. Claims, USAA, to Claims Personnel (June 11, 2001) (discussing changes in USAA's structured settlement program intended to leverage internal resources for the benefit of the corporate enterprise) (facsimile on file with author); *see also Macomber*, 804 A.2d at 186 (discussing Travelers' rebating and short-changing schemes).

[108] Memorandum from L. Charles Landgraf, LeBoeuf, Lamb, Leiby & MacRae, to Randy Dyer, Executive Vice President, National Structured Settlements Trade Association, Re: Commission Rebates by Structured Settlement Brokers (May 3, 1989) (copy on file with author).

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> There has been little State enforcement of anti-rebating laws and many insurance departments' failure to apply the anti-rebating laws to 'indirect' rebates may be due more to the subtlety of the transaction and the lack of specific guidance from the courts or State attorneys general on what constitutes an "indirect" rebate, than any conscious policy to permit the practice.
>
> We believe that a program to alert State regulators to the practice could be devised that would result in greater scrutiny of these practices which appear to contravene statutes. However, any such collective activity to enforce these anti-rebating laws raises a number of sensitive issues, not addressed in this memorandum, and we would welcome the opportunity to discuss these with your group.[109]

Instead of alerting state regulators of the need to curb rebating within the structured settlement industry, NSSTA chose to let its members make their own decisions. NSSTA "uncovered all the information that pertained to the matter at hand; it had the information professionally analyzed; and it presented both the raw information and the findings to the membership so they could make informed decisions within their own company on the matter at hand."[110] The result has been the proliferation of rebating throughout the country that we see today.

B. Settlement Funds Provide Choices for Ultimate Consumers

Plaintiffs' advocates argue that it is well settled in common law and in free-market society that the consumer has the ultimate right of choice. In their view, the consumer has the right to select a product from all products available in the marketplace. Along with choice of product, the consumer has the right to choose from whom they will buy. Consumer choice is protected in numerous federal laws, such as the antitrust laws,[111] which indicate a public policy preference to let the free market decide what products get sold.

Insurance laws are adopted by states to protect the consumer.

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[109] *Id.*

[110] *See* E-mail from Randy Dyer, Executive Vice President, NSSTA, to Richard B. Risk, Jr. (Dec. 30, 2002) (on file with author).

[111] *See generally* Sherman Antitrust Act, 15 U.S.C. §§ 1-7 (2003); Clayton Act, 15 U.S.C. §§ 12-27, 29 U.S.C. §§ 52-53 (2003).

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Even though the claimant in a structured settlement will not own the annuity (ownership would cause the loss of tax benefits), when the transaction is complete the annuity company will be making direct periodic payments to the claimant or other payee. In that sense, the claimant is the ultimate consumer. Neither the defendant nor its liability insurer will depend on the product to perform as promised by its issuer, because they are not the consumer. The victim/claimant is the ultimate consumer. The claimant's status as ultimate consumer suggests that he should be able to select the annuity broker. Allowing the claimant to choose the broker would help avoid the abuses and unfair practices that can occur today.

There are any number of reasons for choosing a QSF.[112] While any particular reason could be a valid reason for creating a QSF, the law does not require that there be a reason.[113] Likewise, there is nothing in the Code, legislative history, regulations, or rulings to suggest that a reason is necessary or that the QSF exist for a minimum length of time. The only requirement is that the QSF comply with Treasury Regulations section 1.468B-1(c).[114]

As long as there is no definitive guidance from Treasury and the Service, those whose business plans revolve around controlling the choice of annuity providers can continue to sow seeds of doubt among injury victims, their lawyers, and the courts that adverse tax consequences will result. Definitive guidance should end these campaigns to discredit the use of the QSF in single-claimant scenarios.

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[112] Reasons for choosing a QSF could include: (1) desire to avoid having an adversary handle what may be the largest financial transaction of the injury victim's life; (2) desire to avoid a legal malpractice claim by the claimant against her own attorney for allowing the defense to commit fraud during the settlement process or cause unnecessary adverse tax consequences; (3) desire to select an annuity market from the entire marketplace, taking advantage of free market competition; (4) desire to preserve the option of the claimant to receive tax-free periodic payments, while allowing the defendant(s) to be dismissed; (5) desire to receive funds while preserving the structured settlement option for any and all claimants, and allowing the defendant(s) to be dismissed; (6) desire to receive and hold funds while other matters are being considered, such as the determination of liens and their amounts or the need to establish a supplemental needs trust under 42 U.S.C. § 1396p(d)(4)(A) to preserve Medicaid and Supplemental Security Income (SSI) eligibility; and (7) desire to receive funds for a gravely injured person while the defense's accepted offer is still enforceable, since the death of the claimant changes the circumstances and likely would cause the defense to renegotiate for a reduced amount.

[113] *See* Treas. Reg. § 1.468B-1(c)(2) (1993).

[114] *See id.* § 1.468B-1(c).

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C. "Approved Lists" Enable Companies to Control Annuity Placement and Who Gets Paid

A system of "approved markets" operates ostensibly to protect the liability insurers from defaults by annuity issuers. Yet, starting in 1983, the liability to make future payments as part of a settlement agreement could be transferred to a third-party obligor.[115] This means that the defendant or liability insurer no longer has a legitimate reason (stemming from default concerns) to dictate which annuity company, obligor, or secondary guarantor the claimant selects. Once the periodic payment obligation is assumed by the assignment company, the original obligor is released not only from the original tort liability, which occurs in the settlement agreement, but also from the periodic payment obligation, which is created in the settlement agreement. The only possible recourse the claimant has to the original obligor is for things like misrepresentation of value on which the claimant has relied, or in the case of default, for dictating the choice of annuity markets and guarantors. The claimant assumes all risk once the periodic payment obligation is assigned to the third party.

An example of the approved market list program, typical of most, is the one maintained by Allstate. An internal memo explains it as follows:

> The Structured Claim Settlement process is initiated with a call to a P-CSSO/Encompass approved Broker. Provided with the pertinent case information, the Broker is asked to formulate proposals that address the needs of the Claimant. The proposals provided by the Broker should be quoted with Allstate Life as the annuity issuer. . . .
>
> Although our initial objective is to place the business with Allstate Life, occasionally, a claimant or claimant's representative requests another life insurer be quoted. Reasons for the request could be 1) Claimant and/or attorney preference for a company known to them; 2) Knowledge of a

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[115] *See* Periodic Payment Settlement Act of 1982, Pub. L. No. 97-473, 96 Stat. 2605 (1983) (codified at I.R.C. § 104(a)).

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> more competitive price (provided by a plaintiff broker/consultant or a codefendant broker); or 3) Court directive.
>
> When a request of this type occurs due to price considerations, the Broker is required to provide Allstate Life's Structured Settlements Sales Support with a last right of refusal to match the lower cost and to obtain confirmation that this process has been carried out. In most cases, Allstate is able to issue the annuity at the competitive price.
>
> Requests based on Claimant preference are more difficult to resolve. Our efforts are to address the needs of the Claimant. In the limited number of situations in which Allstate Life is not the company of choice, the Broker is required to quote from the following approved insurer list. . . .[116]

When the liability P&C insurer restricts the choice of annuity markets to about seven or eight of the approximately twenty viable and highly-rated companies in the marketplace, chances are good that the claimant loses at least some of the benefits of competition. Annuity issuers on a list of "approved markets" do not need to be as competitive as the rest of the marketplace because the claimant cannot choose a market that is not on the list. This means that markets on the approved list have more opportunity to keep their prices high.

D. Denial of Tax Benefits from a Structure Violates Public Policy

When a settling claimant is presented with a Hobson's choice of periodic payments either from a life insurance company affiliated with the tortfeasor's liability insurer or a cash lump sum (and loss of the subsidy intended by Congress to entice injury victims to elect periodic payments), it is not surprising to see claimants opt for the cash instead of the structure. Denying the opportunity to receive tax-free periodic payments is contrary to public policy, which provides a federal subsidy as encouragement to the victim to elect periodic payments to protect

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[116] Memorandum from John McCulloch, Marketing Manager, Allstate Life Insurance Company Structured Settlements, to Allstate employees, Re: Structured Claim Settlements – Approved Life Insurers (Oct. 19, 2001).

against spendthrift behavior.[117] The practice of limiting a claimant's choice of annuity markets has adversely affected the growth of structures.[118] Structures are good public policy because the use of the qualified settlement fund removes the defendant and its insurer from the damage recovery disbursement decision and increases their acceptance by plaintiffs. By discouraging the use of structures, for profiteering or other reasons, defendants and their insurers are acting in contravention of public policy.

While the actions of P&C companies and their agents is not a technical tax issue, it is a public policy issue with its genesis in a report from the Joint Committee on Taxation. The main thrust of this report was to discuss proposed legislation to initiate a tax on the purchase of future settlement payments. The purpose of the tax benefit intended by Congress was made clear in the following excerpt:

> [I]t can be argued that the choice of the lump sum settlement may create an externality, that is, a cost to taxpayers at large, not borne by the individual who chooses the lump sum settlement. This externality could arise as follows. The amount of damages in a case involving personal physical injuries or physical sickness may be based on the lifetime medical needs of the recipient. If a recipient chooses a lump sum settlement, there is a chance that the individual may, by design or poor luck, mismanage his or her funds so that future medical expenses are not met. If the recipient exhausts his or her funds, the individual may be in the position to receive medical care under Medicaid or in later years under Medicare. That is, the individual may be able to rely on Federally financed medical care in lieu of the medical care that was intended to have been provided by the personal

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[117] *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999), *available at* http://www.house.gov/jct/x-15-99.htm. This document accompanied H.R. 263, 106th Cong. (1999). Code section 5891 was enacted by a subsequent version of that bill, H.R. 2884, 107th Cong. (2002). Generally, section 5891 provides for an excise tax of 40 percent of the "factoring discount" (subsection (a)) on the transfer of the right to receive structured settlement payments, unless the transfer is approved in advance under the authority of an "applicable state statute" (subsection (b)(3)) by an "applicable state court" (subsection (b)(4)), which must consider the "best interest of the payee, taking into account the welfare and support of the payee's dependents" (subsection (b)(2)(A)(ii)). I.R.C. § 5891.

[118] *See* Risk, *supra* note 1, at 903 n.62 (describing the growth of structured settlements from 1976 to 1993).

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> injury award. Such a 'moral hazard' potential may justify a subsidy to encourage the use of a structured settlement arrangement in lieu of a lump sum payment to the recipient, to reduce the probability that such individuals need to make future claims on these government programs. Under the structured settlement arrangement, by contrast to the lump sum, it is argued that because the amount and period of the payments are fixed at the time of the settlement, the payments are more likely to be available in the future to cover anticipated medical expenses . . . .[119]

The benefit referred to as a "subsidy" is intended to provide an incentive for physically injured claimants to accept periodic payments and thus guard against spendthrift behavior that might later make these victims wards of society. Despite Congress's intent to provide victim's with this benefit the threat of lost of tax benefits can be used as leverage to force injury victims into allowing the liability carrier to dictate the selection of the annuity issuer and the structured settlement specialist to receive the commission.

E. The Need for Guidance Has Been Created by Treasury and the Service

The need for additional guidance from Treasury and the Service has been created in part by those agencies. NSSTA has widely distributed a letter referring to a conversation between a representative of an insurance company member of NSSTA and an unnamed person at the Service, indicating that single-claimant QSFs were subject to adverse tax treatment.[120] The author, after contact with officials, has determined and reported that there is tension within the Service on this subject.[121]

Hogan & Hartson, LLP, which serves as general counsel and tax counsel to NSSTA, is in regular communication with and makes frequent visits to staff attorneys at Treasury and the Service. Based on these communications, the firm has reported to the NSSTA membership on numerous occasions its conclusion that there is a risk of adverse tax treatment when a qualified assignment is made from a

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[119] *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999), *available at* http://www.house.gov/jct/x-15-99.htm; *see also supra* note 54 and accompanying text.

[120] *See* Risk, *supra* note 1, at 896.

[121] *See id.* at 896 n.156.

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QSF created for a single claimant or when there has been a prior allocation of the funds to be transferred. For example, Hogan & Hartson attorney William L. Neff said in his written remarks, *Ability of Section 468B funds to Make Section 130 Assignments*, to the NSSTA 1997 Annual Meeting:

> The IRS is aware that single party and related party section 468B funds are being implemented. It is the view of certain IRS officials that section 468B does not override the general rules on constructive receipt and economic benefit. If constructive receipt and economic benefit rules apply, there could be no section 130 assignment from a one-person section 468B trust. The funding of the 468B trust and the elimination of all possible claims against the trust other than the single claimant would cause that claimant to have the economic benefit of the funds in the trust.
>
> In the view of these officials the purpose of section 468B was to deal with the problem of "homeless" income, i.e. income on accounts, escrows and other funds that all parties treated as attributable to some other party. Section 468B provides that the account, escrow, fund or trust is itself a taxable entity. The statement in the regulations that a section 468B trust is a trust is established [*sic.*] "to resolve or satisfy one or more contested or uncontested claims" is a part of the definition of a "qualified settlement fund" and nothing more. That the "one or more" phrase is repeated in Revenue Procedure [93-34][122] authorizing qualified assignments from qualified settlement funds again in only part of the definition of a qualified settlement fund under section 468B. Just because the fund is a section 468B fund does not mean that every assignment of a settlement of a section 104(a)(2) claim will qualify under section 130.
>
> *These same IRS officials acknowledge that other IRS officials may have the view* that the regulations under section 468B, as applied in Revenue Procedure [93-34], do amount to an overruling of the general rules of constructive receipt and economic benefit to some extent, at least if there is more than

[122] Neff consistently referred to Rev. Proc. 93-64 in his printed text. He meant Rev. Proc. 93-34, and I have made that correction throughout his text.

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> one claimant. Under the rules of economic benefit, a third party assuming the liability to make payments to a claimant would be treated as the receipt of the present value of all future payments by the claimant. Congress clearly could not have intended this result or section 130 would not work in any circumstances. It follows that Congress must have intended to overrule these general rules when applied to section 130 qualified assignments despite the explicit statement in the legislative history to the contrary. If the general rules of constructive receipt and economic benefit do not apply to section 130 qualified assignments, in general, *these other officials conclude* that constructive receipt and economic benefit do not necessarily apply to section 130 qualified assignments from section 468B funds particularly in light of the "one or more" language in the regulations and Revenue Procedure [93-34].[123]

It is significant to this discussion that Neff reported an internal division of opinion among Service staff members as to the answer to this question. This is disturbing news to physical injury victims and their attorneys who desire to have settlement damage recovery funds paid into a QSF.

Neff's presentation to the NSSTA annual meeting obviously meant to discourage the use of QSFs in single-claimant cases. He concludes that, "it is my opinion that single claimant section 468B funds cannot do qualified assignments."[124] Neff bases his conclusion on the concept of economic benefit, arguing that the claimant would be treated as having received the amount transferred to the QSF because "the claimant will get everything—there is no one else."[125] But, as I have pointed out, the Service reached the opposite conclusion in Revenue Ruling 79-220, when it held that there was no constructive receipt or economic benefit in a structured settlement where the obligor held a funding asset exclusively for a single payee, but the payee had rights only to the periodic payments.[126] Congress specifically agreed with the Service in the House and Senate reports

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[123] William L. Neff, Ability of Section 468B Funds to Make Section 130 Assignments, Address to the National Structured Settlements Trade Association Annual Meeting (May 7-11, 1997) (emphasis added) (transcript on file with author) [hereinafter Neff 1997 Address].

[124] *Id.*

[125] *Id.*

[126] *See* Rev. Rul. 79-220, 1979-2 C.B. 74.

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accompanying the Periodic Payment of Judgments Tax Act of 1982, stating that it did not intend to change existing law, only to codify it.[127] The reports cited Revenue Ruling 79-220 as one of three rulings integral to existing law, noting specifically that constructive receipt and economic benefit did not apply.[128] Payment into a section 468B fund (QSF) provides an additional layer of separation between the fund and the claimant, because the claimant is not even a payee until the fund settles with the claimant.

Neff's analysis is similarly flawed in his discussion of a section 468B fund that is created for the benefit of multiple claimants. He says:

> I believe the real tax concern for "qualified assignments" from a section 468B fund involving related parties is that the parties would have agreed in advance of the funding of the section 468B fund on the share of each of the parties. If there is an agreement among the claimants as to shares, that agreement may become an enforceable agreement on the funding of the section 468B fund and the release of the defendant and defendant's insurer. If there is such an agreement, claimants would have received an economic benefit on the funding of the section 468B fund and a qualified assignment could not be made by the section 468B fund.
>
> . . .
>
> In a challenge to an assignment from a section 468B fund, the IRS and the courts would consider all surrounding facts and circumstances to determine if an enforceable agreement as to shares in the settlement was in place prior to the purported "qualified assignment." One fact that could be given considerable weight would be the period of time between funding the section 468B fund, the resolution of each parties' claims against the fund and the "qualified assignment." If the period is short, for example, all taking place over the space of a few hours, it seems probable that the parties have already agreed as the shares of the settlement. Section 468B funds

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[127] H.R. REP. NO. 97-832, pt. II, at n.2 & Explanation of Provisions (1982).

[128] *Id.*

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> frequently have elaborate procedures for resolving claims against the funds spelling out notice procedures, factors considered, hearing rights, and appeal rights. The absence of such procedures would indicate the procedures were unnecessary because there were no disputes to resolve.[129]

The fallacy of these arguments is that they all depend on the theory that there can be no allocation of the damage recovery amount among the claimants prior to the QSF being funded. If there is an allocation, under this theory the individual has the economic benefit of her portion of the damage recovery. This reasoning omits the fact that, in every case, before distribution can occur, there must be an allocation. Whether that allocation occurs before the QSF is established or seconds before disbursement of the funds, under this theory economic benefit triggers and there can be no qualified assignment from the QSF. Therefore, even when a QSF is established for the benefit of multiple claimants, economic benefit will always occur. Congress obviously did not intend this result.

In a February 2001 memorandum to the NSSTA board, Neff again reported on recent contacts he had made with the Service to determine the status of pending matters relating to section 468B.[130] Again, his report illustrates significant internal tension over whether a qualified assignment may be made from a QSF created for the benefit of a single claimant. The message to the structured settlement community and the general public is still very unsettling. Apparently nobody within Treasury or the Service knows what the outcome of a ruling on this matter would be. Neff wrote:

> The responses of the IRS staff to my inquiries made it clear that the staff already had a high degree of familiarity with the use of section 468B trusts in connection with structured settlements. They were aware that section 468B trusts had been used in connection with structured settlements in single plaintiff tort cases and advised me that *there may be no consensus* regarding the use of section 468B trusts in connection with structured settlements that involve a single plaintiff.

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[129] *See* Neff 1997 Address, *supra* note 123.

[130] Memorandum from William L. Neff, Hogan & Hartson, LLP, to NSSTA Board of Directors (Feb. 21, 2001) (on file with author).

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> The informal view expressed in the IRS branch was that section 468B deals with the issue of "homeless" income during the pendency of litigation, after a fund has been created. The reference to "one or more claims" in the Treasury Regulations under section 468B and in the revenue procedure is definitional regarding what is covered by section 468B. The reference to "one or more claims" is not viewed as having any interpretive bearing on constructive receipt or economic benefit issues that might arise in conjunction with section 130 qualified assignments of structured settlements involving section 468B trusts. The IRS staff volunteered that the issues of constructive receipt and economic benefit are more complicated if there are multiple claimants with derivative claims and if minors are involved.
>
> These individuals also noted that they were aware that section 468B trusts which had very limited period of existence were being used in tort cases. They suggested that this may not be consistent with the legislative purpose of section 468B which was to deal with the taxation of "homeless" income after a claim was funded but before the damages were distributed.
>
> The individuals at the IRS stated that they understood that *some individuals, particularly at Treasury, may have a more expansive view of the scope of section 468B in tort cases.* They have heard it suggested that the "one or more claims" language may be sufficient to override normal constructive receipt and economic benefit rules to allow assignments in single plaintiff cases using section 468B trusts. Particularly considering the change in personnel that is likely to occur in connection with the change of administration, *the individuals at the IRS would not hazard a guess as to the "governmental" position* on the application of section 468B to single plaintiff section 130 assignments.[131]

Others in the industry appear to be using Treasury's inaction to their benefit. For example, John McCulloch, Director of Structured Settlements for Allstate Life Insurance Company, gave a presentation

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[131] *Id.* (emphasis added).

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called *Qualified Settlement Funds (468B)* to the regional meeting of the NSSTA held in January 2004 in Los Angeles. His presentation recounted many of the usual arguments against the use of single-claimant QSFs to make qualified assignments.[132] After defending his company's position, McCulloch concluded that "[w]ith the posture of Treasury at question and the issue unresolved, we choose to wait for clarity from Treasury."[133]

This conflicts with the actions of Steven Boger, former vice president for structured settlements at Allstate,[134] who wrote a letter to Treasury and Service officials dated July 24, 2003, while serving as president of the NSSTA. Boger's letter opposed the need for written guidance on qualified assignments from single-claimant QSFs.[135] He offered the history of Revenue Procedure 93-34, which he said was published at the instigation of NSSTA in 1993 and which did not request guidance for single-claimant cases. Boger said:

> In the individual tort claimant situation, there was no such need for guidance because the defendant (or its liability carrier) making the section 130 qualified assignment clearly was "a party to the suit or agreement" under Code section 130(c)(1) and hence the claimant in an individual tort situation clearly could avail himself or herself of the section 130 periodic payment mechanism already. Therefore, Rev. Proc. 93-34 was not intended to address the situation of a single claimant.[136]

Boger subsequently led a delegation from NSSTA to meet in late September 2003 with Treasury and Service officials, presumably to lobby against the issuance of formal guidance.[137] Boger's efforts to

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[132] John McCulloch, Allstate Financial, *Qualified Settlement Funds (468B)* (PowerPoint™ presentation obtained by the author from "Members Only" section of National Structured Settlements Trade Association web site).

[133] *Id.*

[134] Boger departed Allstate in late 2003, before his term as president of the NSSTA ended, causing him to resign that post.

[135] Letter from Steve Boger, President, NSSTA, to Pamela F. Olson, Assistant Secretary (Tax Policy), Department of the Treasury, Emily A. Parker, Acting Chief Counsel, Internal Revenue Service, and several "cc" addressees at Treasury or the Service: Eric Solomon, Helen Hubbard, Gary Wilcox, Robert Brown, Tom Luxner and Mike Montemurro (July 24, 2003) (on file with author).

[136] *Id.*

[137] Boger sent a memo dated October 2, 2003, to NSSTA members, "Report on 468B Meeting at Treasury," confirming essentially that they had discussed the topics

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persuade Treasury and the Service not to issue guidance on the single-claimant QSF combined with McCulloch's statement that Allstate is waiting "for clarity from Treasury" to ring hollow.[138] Industry seems to prefer avoidance of definitive answers to the tax treatment questions raised by McCulloch in his January 2004 presentation to NSSTA. Others have joined in the campaign to create doubt over the viability of single-claimant QSFs. Frank A. Pension is owner of The Pension Company, and a longtime structured settlement broker and staunch advocate of defense control over the structured settlement process. Pension, who is not an attorney, gave an affidavit that was filed with the court in a case in which the proposed use of a QSF would remove his company entirely from the settlement process. The defendant or its insurer, Pension's client, had agreed to pay $1.85 million for the benefit of the claimant, part of which was due to be structured. He attached, as supporting documentation, both the above-cited Neff memorandum to the NSSTA Board of Directors and a copy of Neff's presentation to the NSSTA Annual Meeting.[139] Pension's statement reads, in part:

> The plaintiff in this case proposes to utilize a 468B Trust, though it involves only an individual claim [Emphasis in original.] against the defendants. Arbitrarily citing only the "one or more" language associated with Revenue Procedure 93-34 and the Treasury Regulations associated with § 468B of the Code, the plaintiff not only contends that a § 468B Trust can be created to fund a tax-free structured settlement in this case outside a class action scenario, but also suggests ignoring the other applicable tax law principles of constructive receipt and economic benefit. This is arguably an abuse of the 468B status and could destroy the tax-free aspect of all the future periodic payments to the infant, Alfonse D. Scinta. Neither the IRS nor the Treasury Department have issued any rulings

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in his July 24, 2003, letter.

[138] *See supra* notes 134-35 and accompanying text.

[139] Mr. Neff's presentation to the 1997 NSSTA Annual Meeting is also discussed elsewhere in this article. *See* Neff 1997 Address, *supra* note 123 and accompanying text. Mr. Pension also included a bulletin, Structured Settlement Update, Winter 1996, "Questions and Answers About Section 468B – Qualified Settlement Funds," by David M. Higgins, then a partner at Brobeck, Phleger & Harrison, LLP, Los Angeles. Mr. Higgins, who is the acknowledged drafter of the Periodic Payment Settlement Tax Act of 1982, has since recanted his earlier position on the risk associated with single-claimant QSFs and much of his tax law practice involves the creation and administration of single-claimant QSFs.

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> or regulations that creating a structured settlement from a 468B settlement fund under the circumstances involved here for a single claimant or a family unit with no real adverse economic interests would receive tax-free status. To the contrary, it seems more probable that this transaction would trigger severe adverse tax consequences to the infant, Alfonse D. Scinta.[140]

McCulloch's presentation follows a request for clarification by some very knowledgeable tax practitioners at Skadden, Arps, Slate, Meagher & Flom, LLP. Members of that firm submitted a letter dated June 19, 2003 requesting that the Service and Treasury publish guidance for section 130.[141] This letter requested clarification that assignment of a liability to make periodic payments does not fail to be a "qualified assignment" for purposes of section 130 solely because the settlement proceeds are held temporarily in a qualified settlement fund, as defined in Treasury Regulations section 1.468B-1(c), before the periodic payment liability is assigned.[142] The letter and its attachments recommended an amendment to Revenue Procedure 93-34 and suggested text that would modify and supercede that Revenue Procedure to make clear that a QSF may make a qualified assignment under section 130 in single claimant cases.[143]

The industry is using reports of conflict within the Treasury to maintain the status quo. Since the apparent confusion is being used to contravene public policy, Treasury itself is creating the need for clarification. Treasury needs to issue written guidance.

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[140] Affidavit by Frank A. Pension for Defendant Kathleen J. VanCoevering, Scinta v. VanCoevering, 726 N.Y.S.2d 520 (N.Y. App. Div. 2001) (No. I 1994/7829) (May 22, 2001) (parenthetical references omitted).

[141] Fred Goldberg et al., *Attorneys Urge Treasury to Publish Guidance on Personal Liability Assignments*, TAX NOTES TODAY (July 3, 2003) (LEXIS, FEDTAX lib., TNT file, elec. cit., 2003 TNT 128-24). The tax credentials of the Skadden Arps letter signatories are stellar. Fred Goldberg served as chief counsel of the Service from 1984 to 1986, as commissioner of the Service from 1989 to 1992, and as assistant secretary of the Treasury for tax policy during 1992. Kenneth Gideon served as chief counsel of the Service from 1981 through 1983 and as assistant secretary of the Treasury for tax policy from 1989 to 1992. They were both in key policymaking positions at the time Treasury Regulations section 1.468B and Revenue Procedure 93-34 were being developed. Jody Brewster is also formerly with the Service, and her name appears on several key rulings affecting structured settlements.

[142] *Id.*

[143] Rev. Proc. 93-94, 1993-2 C.B. 470.

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IV. CONCLUSION

The Secretary has the power to issue rules and regulations, and "shall prescribe all needful rules and regulations."[144] Treasury Regulations section 1.468B and Revenue Procedure 93-34, which both became effective in 1993, do not adequately provide all "needful" guidance for the promulgation and enforcement of Code section 468B, which was enacted as part of the Tax Reform of 1986 and amended under the Technical and Miscellaneous Revenue Act of 1988.

Victims and their families are being injured by P&C companies and their "approved list" structured settlement specialists. This behavior contravenes public policy. The "subsidy" of tax-free growth being made available to physical injury or sickness victims in tort claims, a public policy intended by Congress,[145] is wrongfully being withheld by self-insured entities and P&C insurance companies, their claim adjusters, the attorneys they hire to defend their insured tortfeasors, and approved brokers who have agency relationships with the insurers. This withholding of the subsidy is done to force injury victims to allow the defense to dictate who will issue the annuity and who will receive the commission.

The majority of this behavior would be averted through widespread use of QSFs, whether for multiple claimants or single claimants. The structured settlement industry in its current formulation is actively conducting a campaign to maintain the status quo by planting seeds of doubt in the minds of injury victims and their attorneys that the victims are at risk for adverse tax consequences if a QSF is used. The big players in today's structured settlement industry do not want written guidance on this issue because, without it, they can continue business as usual.

This conduct takes place against a backdrop of government indecision. Treasury and the Service cannot agree internally on

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[144] I.R.C. § 7805(a). The section states in full:

> Except where such authority is expressly given by this title to any person other than an officer or employee of the Treasury Department, the Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

Id.

[145] *See* JOINT COMM. ON TAXATION, TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (JCX-15-99) (1999), *available at* http://www.house.gov/jct/x-15-99.htm.

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whether a QSF created for the benefit of a single-claimant can make a section 130 qualified assignment. This paralyzes the process of private rulings, since non-binding private rulings are rendered by non-policymaking staff attorneys who reportedly are in disagreement with the policy makers and among themselves. The fact that this intra-agency tension has been made public creates even more doubt as to the risk of adverse tax consequences. As a result, the possibility of adverse tax consequences looms when a QSF is used not just in single-claimant cases, but in other cases where the claimants are related and the allocation process is not arm's-length.

The public deserves clear guidance from the government on how the Code will be administered and enforced, particularly since more than $6 billion annually is at issue.[146] The case for priority on interpretation of this issue is even stronger when one considers the protracted period that has elapsed from the time the law was enacted in 1986 to the present. The Secretary of the Treasury has a duty to decide the policy question and promulgate an outcome without further delay.

The technical tax arguments are persuasive—economic benefit does not attach to assets of a QSF while they are being held temporarily for further distribution. Despite the strength of the case for the position that economic benefit does not attach to such assets, the evidence of internal tension at Treasury and the Service on this issue makes a compelling argument that immediate issuance of "needful" guidance is called for. For political reasons, however, Treasury and the Service may decide not to act. If there is a decision not to act on the request for published guidance, taxpayers who have suffered physical injuries or sickness through the negligence of others will continue to be victimized by the structured settlement industry. Or, they might opt to forego their considerable tax benefits. Either way, the public loses.

[146] Press Release, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003), *available at* http://www.nssta.com.

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Goldberg et al 6

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June 19, 2003

Pamela F. Olson
Assistant Secretary (Tax Policy)
Department of Treasury
1500 Pennsylvania Avenue, N.W.
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B. John Williams
Chief Counsel, Internal Revenue Service
1111 Constitution Avenue, N.W.
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Re: Section 130 Qualified Assignments

Dear Assistant Secretary Olson and Chief Counsel Williams:

We respectfully request that the Internal Revenue Service ("IRS") and Treasury Department ("Treasury") publish guidance under section 130 of the Internal Revenue Code (the "Code").[1] In general, section 130 provides that, in the case of a "qualified assignment" of a liability to make periodic payments of damages on account of personal injury, the assignee may exclude from gross income the amount it receives for assuming the liability to the extent assets are acquired to fund the periodic payments. We request guidance clarifying that the assignment of a liability to make periodic payments does not fail to be a "qualified assignment" for purposes of section 130 solely because the settlement proceeds are held temporarily in a qualified settlement fund (as defined in Treas. Reg. § 1.468B-1(c)) before the liability is assigned.

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[1] Unless otherwise indicated, all section references are to the Code.

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The failure of a number of insurance companies and the financial weakness of others have led to concerns about the safety, security and long-term viability of traditional annuity-based structured settlements. These concerns have resulted in the use of qualified settlement funds in many structured settlements today to ensure that the assets needed to fund the future periodic payments to the claimant will be secure.

We understand the IRS currently is considering whether, in a situation where the settlement involves a single claimant and a qualified settlement fund to facilitate assignment of the liability to make periodic payments to the claimant, the judicial economic benefit doctrine may somehow apply to cause the assignment to fail to be a qualified assignment under section 130. We believe that application of the economic benefit doctrine to disqualify an otherwise qualified assignment would be contrary to section 130, Congress' intent in enacting the 1988 statutory amendment, and the policy underlying Rev. Proc. 93-34, 1993-2 C.B. 470, which provides procedures under which qualified settlement funds can be used to facilitate a qualified assignment under section 130. Application of the economic benefit doctrine to qualified settlement funds used to facilitate qualified assignments would as a practical matter render Rev. Proc. 93-34 a nullity. Because this issue impacts a substantial number of structured settlements involving an assignment of the liability to make periodic payments, we believe the issue should be addressed in published guidance.

Attached for your convenience is a memorandum that describes structured settlements involving the assignment of a liability to make periodic payments to a claimant and discusses the tax consequences of such settlements. Also attached is a proposed revenue procedure that we believe would provide the requested clarification. The proposed revenue procedure would modify and supercede Rev. Proc. 93-34 to make clear that a qualified settlement fund may make a qualified assignment under section 130 in a case involving a single claimant. For your convenience, we have also attached a blackline comparing the proposed revenue procedure to Rev. Proc. 93-34.

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We would appreciate the opportunity to discuss this issue with you and others from the IRS and Treasury. If you have any questions or would like additional information, please call Fred Goldberg at (202) 371-7110, Ken Gideon at (202) 371-7540, or Jody Brewster at (202) 371-7238.

Sincerely,

Fred Goldberg

Kenneth Gideon

Jody Brewster

cc: Eric Solomon
Helen Hubbard
Gary Wilcox
Robert Brown
Tom Luxner
Mike Montemurro

436379

Tax Consequences of a Single-Claimant Qualified Settlement Fund Used to Facilitate a Qualified Assignment under Section 130 of the Code

The failure of a number of insurance companies and the financial weakness of others have led to concerns among settling claimants about the safety, security and long-term viability of traditional annuity-based structured settlements. These concerns have resulted in the use of a qualified settlement fund as defined in Treas. Reg. § 1.468B-1(c) ("QSF")[1] to structure many settlements today to ensure that the annuities used to fund the periodic payments to a claimant will be safe, secure and viable.[2] Some defendants and their insurers have suggested that the economic benefit doctrine prevents a QSF from making a "qualified assignment" under section 130 of the Internal Revenue Code (the "Code"), particularly in settlements involving a single claimant, but also in multiple-claimant settlements where the amount paid to the QSF by the defendant or its insurer has been pre-allocated among the claimants.

This document (1) provides general background regarding the tax consequences of structured settlements; (2) describes variations of structured settlements that involve a single claimant, an assignment of the liability to make periodic payments to the claimant, and the use of a QSF; and (3) analyzes the impact, if any, of the economic benefit doctrine on an otherwise "qualified assignment" as defined in section 130(c) of the Code.

In summary, application of the economic benefit doctrine to prevent a qualified assignment by a QSF under section 130 would be contrary to the clear statutory override of that judicial doctrine in section 130, Congress intent underlying the 1988 amendment to section 130, and the policy underlying Rev. Proc. 93-34, 1993-2 C.B. 470. Given the uncertainty that exists in negotiations of structured settlements, Treasury and the IRS should publish guidance clarifying that the

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1 A small number of structured settlements use a "designated settlement fund" as defined in section 468B(d)(2) of the Code ("DSF"), rather than a QSF. QSFs generally are preferred because the QSF regulations provide more complete guidance for taxpayers than does the statute providing for DSFs. For the sake of convenience, this document addresses only QSFs. However, the same issues and legal principles apply in the case of DSFs as well.

2 Additional considerations that result in the use of a QSF include (1) ensuring that the distribution of settlement proceeds, including periodic payments, is designed to meet the needs of the claimant; (2) ensuring that the claimant has the full benefit of a competitive free market for funding assets; and (3) ensuring that settlement proceeds are transferred at a time when the defendant or the defendant's insurer is solvent and funds are available.

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economic benefit doctrine does not apply to prevent a QSF from making a qualified assignment under section 130. The attached draft revenue procedure, which would modify and supercede Rev. Proc. 93-34, contains the type of guidance that would provide the necessary clarification.

Background

Sections 104, 130, and 468B of the Code and the regulations thereunder interact to provide claimants, defendants and their insurers a great deal of flexibility in structuring the settlements of actions arising from personal physical injuries (*e.g.*, an automobile accident, a plane crash, medical malpractice, or a defective product). Under section 104(a)(2), gross income does not include "the amount of any damages (other than punitive damages) received . . . on account of personal physical injuries or physical sickness." The exclusion from gross income under section 104(a)(2) applies without regard to whether the damages are received pursuant to a lawsuit or a settlement agreement. Section 104(a)(2) (parenthetical language). Thus, if a defendant makes a single, lump-sum settlement payment of damages to the claimant, the lump-sum payment is excluded from the claimant's gross income pursuant to section 104(a)(2). Any future earnings on that lump-sum amount, however, will be taxable to the claimant.

The claimant may reject a lump-sum settlement payment because such a payment does not meet the future needs, for example, of a minor, incompetent, unsophisticated or severely-injured claimant. Instead, the claimant may insist upon periodic payments. The exclusion from gross income under section 104(a)(2) applies without regard to whether the amounts are received in a single lump sum or as periodic payments. Section 104(a)(2) (parenthetical language). Thus, if a defendant agrees to make periodic settlement payments to the claimant, each of the periodic payments received by the claimant is excludable from the claimant's gross income under section 104(a)(2), including the portion of the payments that can be traced to income earned on assets that may have been set aside to fund the periodic payments.

Where a claimant wants to receive periodic payments, but the defendant wants to make a lump-sum payment, a settlement can be structured requiring the defendant to make periodic payments, and the defendant can in turn make a "qualified assignment" pursuant to section 130 of that periodic-payment liability to a third-party (the "assignee") together with the lump-sum payment. Typically, the assignee is an affiliate of an insurance company, and its only business is to accept for a fee qualified assignments of liabilities to make periodic payments to

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tort claimants. Section 130 sets forth rules that apply to a "qualified assignment" of a defendant's or its insurer's liability to make periodic payments to a claimant. Absent section 130, the lump-sum payment received by the assignee would be income to the assignee in the year received, and the assignee would get a deduction for the periodic payments – but only as the payments are made to the claimant. In contrast, if section 130 applies (*i.e.*, because the assignment is a "qualified assignment" as defined in section 130(c)[3]), the lump-sum payment is excluded from the assignee's gross income to the extent the payment received by the assignee does not exceed the assignee's cost of the "qualified funding assets" (Treasury obligations or annuities) acquired by the assignee to fund the periodic payments. In other words, the assignee includes in income only that portion of the lump-sum payment that is not used to purchase qualified funding assets.

Section 130 was added to the Code by the Periodic Payment Act of 1982, Pub. L. 97-473, 96 Stat. 2605, which also amended section 104(a)(2) to exclude from a claimant's gross income any damages received as periodic payments on account of personal injuries. The legislative history to the Periodic Payment Settlement Act of 1982 explains that section 104(a)(2) was amended and section 130 was added to the Code to provide statutory certainty that periodic payments of personal injury damages are excludable from the gross income of the recipient, and that likewise, amounts received by an assignee are excludable from the gross income

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[3] Section 130(c) defines a "qualified assignment" as:

any assignment of a liability to make periodic payments as damages (whether by suit or agreement), or as compensation under any workmen's compensation act, on account of personal injury or sickness (in a case involving physical injury or physical sickness) –

(1) if the assignee assumes such liability from a person who is a party to the suit or agreement, or the workmen's compensation claim, and

(2) if —

(A) such periodic payments are fixed and determinable as to amount and time of payment,

(B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments,

(C) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability, and

(D) such periodic payments are excludable from the gross income of the recipient under paragraph (1) or (2) of section 104(a).

The determination for purposes of this chapter of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor.

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of the assignee to the extent that those amounts are used to purchase annuities or Treasury obligations to fund the periodic payment liability. S. REP. NO. 97-646, 97th Cong., 2d Sess. 4 (1982). The public policy of encouraging structured settlements has been reaffirmed in subsequent legislation.[4]

The interests of a defendant's insurer may also impact settlement negotiations. The defendant's insurer may seek to settle a lawsuit by paying the claimant in periodic payments funded by an annuity from an affiliated life insurance company (or from another company selected by the defendant's insurer). The claimant may reject periodic payments funded by the insurer's affiliated or selected life insurance company because of concerns about its safety, security, and long-term viability.

A settlement between parties with such diverse objectives can be structured using a QSF. A QSF is any fund, account, or trust if—

> (1) it is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

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4 See Joint Committee on Taxation, Tax Treatment of Structured Settlement Arrangements, JCX-15-99 (Mar. 16, 1999), which describes the "public policy interest in tax subsidy for structured settlement arrangements" as follows:

> The amount of damages in a case involving personal physical injuries or physical sickness may be based on the lifetime medical needs of the recipient. If a recipient chooses a lump sum settlement, there is a chance that the individual may, by design or poor luck, mismanage his or her funds so that future medical expenses are not met. If the recipient exhausts his or her funds, the individual may be in the position to receive medical care under Medicaid or in later years under Medicare. That is, the individual may be able to rely on Federally financed medical care in lieu of the medical care that was intended to have been provided by the personal injury award. Such a "moral hazard" potential may justify a subsidy to encourage the use of a structured settlement arrangement in lieu of a lump sum payment to the recipient, to reduce the probability that such individuals need to make future claims on these government programs.

JCX 15-99 accompanied H.R. 263, "The Structured Settlement Protection Act," 106th Cong., 1st Sess. Section 5891 of the Code was enacted by a subsequent version of that bill, H.R. 2884, on January 23, 2002. Generally, Section 5891 provides for an excise tax on the transfer of the right to receive structured settlement payments.

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(2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to at least one claim asserting liability under CERCLA, arising out of a tort, breach of contract, or violation of law, or designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

Treas. Reg. § 1.468B-1(c).

In a structured settlement involving a QSF, the defendant or its insurer transfers its settlement payment to the QSF and is released and dismissed from the suit.[5] The QSF then uses the lump-sum payment from the defendant or its insurer to settle the claims of the claimant against the QSF. Pursuant to the settlement agreement between the QSF and the claimant, the QSF agrees to make periodic payments to the claimant and assigns that liability to an assignee in a qualified assignment acceptable to the claimant. The assignee purchases qualified funding assets to fund the periodic payments. A QSF can make a "qualified assignment" under section 130 of the QSF's liability to make periodic payments to a claimant. *See* Rev. Proc. 93-34, 1993-2 C.B. 470. That is, where a defendant transfers its settlement payment to a QSF, and the QSF agrees to make periodic payments to the claimant, the QSF may subsequently assign that liability in a qualified assignment. Under Rev. Proc. 93-34, the QSF is treated as "a party to the suit or agreement" for purposes of section 130(c)(1).

The Economic Benefit Issue

Under the doctrine of economic benefit, a taxpayer is considered in actual receipt of income when assets are unconditionally and irrevocably paid into a fund or trust to be used for the taxpayer's sole economic benefit. *See Sproull v. Comm'r*, 16 T.C. 244 (1951), *aff'd per curiam*, 194 F.2d 541 (6th Cir. 1952) (employee received current income in the form of amounts irrevocably paid out by

5 Treas. Reg. § 1.468B-3(c) provides that, for purposes of section 461(h), "economic performance" occurs when and to the extent that the defendant makes a transfer to a QSF to resolve or satisfy its tort liability. Absent this special rule, section 461(h)(2)(c) would defer the defendant's deduction until the QSF paid the amount to the claimant.

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employer to a trust for the sole benefit of the employee). Where a QSF makes a qualified assignment under Rev. Proc. 93-34 in a settlement involving a single claimant, two arguments based on the economic benefit doctrine have been suggested by defendants and their insurers to prevent qualification as a "qualified assignment" under section 130(c).

First, it has been suggested that there can be no qualified assignment because the future periodic payments would not be excludable from the claimant's gross income under section 104(a)(1) or (2), as required by section 130(c)(2)(D). That is, if the claimant were considered, by application of the economic benefit doctrine, to have received the defendant's settlement payment at the time that payment was transferred to the QSF, then only that payment would be excludable from the claimant's gross income under section 104(a)(2). Future periodic payments would not be excludable under section 104(a)(1) or (2) as required by section 130(c)(2)(D). Thus, the assignment would fail to qualify as a "qualified assignment."

Second, it has been suggested that there can be no qualified assignment because the assignee has not assumed a liability from a person who is "a party to the suit or agreement" as required by section 130(c)(1). Rev. Proc. 93-34 provides that, if certain requirements are satisfied, a QSF will be treated as a party to the suit or agreement. In the case of a QSF, a "transferor" is a person that transfers money or property to the QSF to resolve or satisfy claims against that person. Treas. Reg. § 1.468B-1(d)(1). Arguably, if a claimant were considered by reason of the economic benefit doctrine to have received the settlement proceeds at the time the proceeds were transferred to a settlement fund, then it would follow that the transferor of the settlement proceeds to the settlement fund would be the claimant, rather than the defendant. If so, the settlement fund arguably would not be a QSF treated as "a party to the suit or agreement" under Rev. Proc. 93-34, and thus, the assignment would not be a "qualified assignment."

Discussion

The economic benefit doctrine does not apply to disqualify an otherwise qualified assignment under section 130. Any other conclusion would be contrary to the statutory language of section 130, the Congressional intent underlying the 1988 amendment to the statute, Rev. Proc. 93-34, and the policy underlying Rev. Proc. 93-34.

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Section 130 and Congress' Intent Underlying the 1988 Amendment

Section 130 expressly provides that the "determination for purposes of this chapter of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor." Section 130(c) (flush language). It is clear from the context in which this statutory language arose that Congress intended this language to preclude application of the economic benefit doctrine to cause an otherwise "qualified assignment" to fail to be a "qualified assignment" for purposes of section 130.

As initially enacted, section 130 restricted the rights that a claimant could have against the assignee and in the assets used to fund the future periodic payments. Specifically, section 130(c)(2)(C) (repealed in 1988) required that "the assignee does not provide to the recipient of such payment rights against the assignee which are greater than those of a general creditor." The legislative history explained that the periodic payments of personal injury damages are "excludable from income only if the recipient taxpayer is not in constructive receipt of or does not have the *current economic benefit* of the sum required to produce the periodic payments." S. REP. NO. 97-646; H.R. REP. NO. 97-832, 97th Cong., 2d Sess. 4 (1982) (emphasis added). Congress later abandoned this "general creditor" restriction.

In 1988, Congress repealed section 130(c)(2)(C), because, in Congress' view, "[r]ecipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of the tax law." H.R. REP. NO. 100-795, at 541 (1988). Congress also added the flush language to section 130(c) to provide that the determination of "when the recipient of periodic payments *is treated as having received any payment* with respect to which there has been a qualified assignment shall be made without regard to any provision of the assignment which grants the recipient rights as a creditor greater than those of a general creditor." Section 6079(b)(1)(A) of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, 102 Stat. 3342 (emphasis added). The legislative history to the 1988 statutory amendment explains that "no amount *is currently includible in the recipient's income* solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor." H.R. CONF. REP. NO. 1104, 100th Cong., 2d Sess. at II-171(1988) (emphasis added). The concepts addressed in the 1988 statutory amendment and its legislative history of "treating a payment as having been received" and "as currently includible in income"

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are economic benefit concepts. Congress' intent was to make clear that these economic benefit concepts do not apply in determining whether there is a qualified assignment for purposes of section 130.

The IRS has interpreted the 1988 amendment to section 130(c) as intended to allow assignments of periodic payment liabilities without regard to whether a claimant has the current economic benefit of the settlement proceeds or the funding assets purchased with those settlement proceeds. In PLR 9703038 (Jan. 17, 1997),[6] a defendant assigned to a trust the defendant's liability to make future periodic payments to the claimant. The trustee used the settlement proceeds it received from the defendant to purchase funding assets and gave the claimant a security interest in the funding assets. The IRS ruled that, assuming all other requirements of section 130(c) were met, the defendant's assignment to the trust of the defendant's liability to make future periodic payments to the claimant was a qualified assignment. In so ruling, the IRS concluded that, although the setting aside of funds in trust for a claimant generally confers an economic benefit to the claimant, "the 1988 amendment to section 130(c) of the Code was intended to allow assignments without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments." Clearly, the fact that the claimant had a security interest in the funding assets did not prevent the assignment from being a qualified assignment. Nor did the fact that the assignee held the settlement proceeds in trust prior to the purchase of the funding assets prevent the assignment from being a qualified assignment.

In summary, the 1988 amendment to section 130(c) precludes any argument that an otherwise qualified assignment fails because the claimant receives the current economic benefit of settlement funds or funding assets that are held in trust.

Rev. Proc. 93-34 and Its Underlying Policy

Rev. Proc. 93-34 also supports the conclusion that the economic benefit doctrine does not apply to settlement proceeds that are held in trust in the context of a qualified assignment under section 130. Rev. Proc. 93-34 permits a QSF to make a "qualified assignment" under section 130 by treating the QSF as a "party to

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6 Private letter rulings referred to herein are not cited as precedent under section 6110(k)(3), but rather to illustrate the thinking of the IRS on the issues addressed.

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the suit or agreement" as required by section 130(c)(1). The premise underlying the revenue procedure is that the economic benefit doctrine does not apply where settlement proceeds are held in a QSF before the QSF makes a qualified assignment to the ultimate assignee.

Although the revenue procedure sets forth numerous requirements for a QSF to be treated as a "party to the suit or agreement,"[7] the revenue procedure gives no indication that a QSF will be treated as a "party to the suit or agreement" for purposes of 130 *only if* the QSF holds funds for the benefit of more than one claimant. Indeed, the revenue procedure contains several references to "claimant" or "plaintiff" in the singular. For example, Section 4.10(3) of Rev. Proc. 93-34 requires that the funding asset purchased by the assignee in connection with an assignment by a QSF must relate to the liability to a "single claimant to make periodic payments for damages." Similarly, Section 4.10(1) of Rev. Proc. 93-34 requires that the claimant agree in writing to the assignee's assumption of the liability of the QSF to make periodic payments to the claimant. Each of these requirements presumes that identifiable assets may be set aside for the benefit of a single claimant, and the revenue procedure nonetheless concludes that the assignments are "qualified assignments" under section 130. Such a conclusion is clearly inconsistent with a conclusion that the economic benefit doctrine somehow applies to preclude a qualified assignment in the case of a single-claimant QSF.

Moreover, if the economic benefit doctrine were to apply in the case of a single-claimant QSF that makes a qualified assignment, then the doctrine would

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7 These requirements, as set forth in § 4.01 of Rev. Proc. 93-34, are:
(1) the claimant agrees in writing to the assignee's assumption of the DSF or QSF's obligation to make periodic payments to the claimant;
(2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) that is either:
(a) a claim arising out of personal injury, death, or property damage in the case of a DSF, or
(b) a claim asserting liability under CERCLA, arising out of a tort, breach of contract, or violation of law, or designated by the Commissioner in a revenue ruling or revenue procedure, in the case of a QSF;
(3) each qualified funding asset purchased by the assignee in connection with the assignment by the DSF or QSF relates to a liability to a single claimant to make periodic payments for damages;
(4) the assignee is not related to the transferor (or transferors) to the DSF or QSF within the meaning of sections 267(b) or 707(b)(1); and
(5) the assignee is neither controlled by, nor controls, directly or indirectly, the DSF or QSF.

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necessarily apply in the case of *every* QSF that makes a qualified assignment, including multiple-claimant QSFs, as well. As a general matter, application of the economic benefit doctrine is not restricted to a fund or trust with only a single beneficiary; the doctrine can apply to a fund or trust in which there are multiple beneficiaries – each with a specified share. *See Pulsifer v. Comm'r*, 64 T.C. 245 (1975) (holding that each of three children had to include in income in the year they won the Irish Sweepstakes the child's one-third share of the winnings that were irrevocably placed into an account with the court solely for the benefit of the children until they reached age of majority). In every case in which a QSF is established to satisfy the claims of multiple claimants, the rules of professional conduct require that a lawyer obtain advance approval from each client of that client's share of the aggregate settlement that funds the QSF.[8] After advance approval is obtained, each claimant has an allocated share of the amount paid to the QSF.[9] If the economic benefit doctrine were applied to trigger immediate receipt by the claimants of those shares, before settlements and qualified assignments were made, then no QSF could ever make a qualified assignment, and thus, Rev. Proc. 93-34 would be rendered meaningless. Clearly, Treasury and the IRS did not intend such a result.

Given the impact of the uncertainty regarding the application of the economic benefit doctrine to negotiations of structured settlements, we request that Treasury and the IRS publish guidance clarifying that the economic benefit doctrine does not apply to prevent a single-claimant QSF from making a qualified assignment under section 130. The attached draft revenue procedure, which would modify and

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[8] This ethical requirement is set forth in Rule 1.8(g) of the American Bar Association Model Rules of Professional Conduct, adopted in all 50 states, which provides, in pertinent part, as follows:

> A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of . . . the clients . . . unless each client consents after consultation, including disclosure of the existence and nature of all the claims . . . and of the participation of each person in the settlement.

The penalty for failure to obtain advance approval is forfeiture by the attorney of his or her legal fees. *See Burrow v. Arce*, 997 S.W.2d 229 (Tex. 1999) (adopting fee forfeiture as a remedy and remanding for trial the issue of whether the rule was violated).

[9] Even if allocation of the settlement proceeds among multiple claimants were not to occur before the QSF is funded, such an allocation would have to occur before the QSF could make a final distribution to the claimants of the funds held by the QSF.

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supercede Rev. Proc. 93-34, contains the type of guidance that would provide the requested clarification.

The requested clarification does not require ultimate resolution of whether the economic benefit doctrine ever applies to a QSF.[10] Rather, what is sought is merely a clarification that a QSF may make a qualified assignment in a case involving a single claimant.

Conclusion

Application of the economic benefit doctrine to prevent a qualified assignment would be contrary to the statutory language of section 130, Congress' intent underlying the 1988 amendment to the statute, and Rev. Proc. 93-34 and its underlying policy. As the IRS itself has recognized, the 1988 amendment to section 130 was intended to allow assignments of periodic payment liabilities without regard to whether a claimant has the current economic benefit of the settlement proceeds or other assets that will be used to fund the periodic payments.

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10 It is open to doubt that the economic benefit doctrine should ever apply to trigger immediate receipt of settlement proceeds by the claimant or claimants of a QSF solely because the QSF has a single claimant or because an allocation of settlement proceeds among multiple claimants has been made. First, there is no indication in the definition of a QSF or otherwise in the regulations or legislative history under section 468B that qualification as a QSF depends upon the number of claimants or the absence of an allocation of an aggregate settlement among the claimants. Second, a QSF is a separate taxable entity that reports and pays tax on the income earned by the QSF (at the highest applicable rate and without use of the lower brackets). Application of the economic benefit doctrine to a QSF could result in both the QSF and the claimant(s) having to report and pay tax on that income. Clearly, such double taxation is not a result intended by Congress, Treasury, or the IRS.

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Revised Rev. Proc. 93-34

1. PURPOSE

This revenue procedure clarifies that, if the requirements for a "qualified assignment" as described in section 130 of the Internal Revenue Code are otherwise satisfied, no amount will be treated as currently received by a claimant solely because a "designated settlement fund" described in section 468B(d)(2) of the Internal Revenue Code or a "qualified settlement fund" described in section 1.468B-1 of the Income Tax Regulations is used to hold monies (i) while claimants are being identified and the amounts allocated to each are being determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

This revenue procedure modifies and supercedes Rev. Proc. 93-34, which provides rules under which a designated settlement fund or a qualified settlement fund will be considered "a party to the suit or agreement" for purposes of section 130. In general, section 130 provides that an assignee may exclude from gross income amounts it receives for assuming the liability of a party to a suit or agreement to make described periodic payments of damages to a claimant.

2. BACKGROUND

.01 Section 130(a) of the Code provides that any amount received for agreeing to a qualified assignment is not included in gross income to the extent that the amount does not exceed the aggregate cost of any qualified funding assets.

.02 Section 130(c) of the Code defines a "qualified assignment" to mean any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness (in a case involving physical injury or physical sickness) if:

(1) the assignee assumes the liability from a person who is a party to the suit or agreement;

(2) the periodic payments are fixed and determinable as to the amount and time of payment;

(3) the periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of the payments;

(4) the assignee's obligation on account of the personal injuries or sickness is no greater than the obligation of the person who assigned the liability; and

(5) the periodic payments are excludable from the gross income of the recipient under section 104(a)(2).

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.03 Section 130(c) of the Code provides that the determination of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of the assignment which grants the recipient rights as a creditor greater than those of a general creditor. Under the statute, "a liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor." H.R. CONF. REP. NO. 100-1104 at 171 (1988). The statute also makes clear that "no amount is currently includible in the recipient's income solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor." Id.

.04 Section 130(d) of the Code defines a "qualified funding asset" as any annuity contract issued by a company licensed to do business as an insurance company under the laws of any state, or any obligation of the United States if:

(1) the annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment;

(2) the periods of the payments under the annuity contract or obligation are reasonably related to the periodic payments under the qualified assignment, and the amount of any such payment under the contract or obligation does not exceed the periodic payment to which it relates;

(3) the annuity contract or obligation is designated by the assignee as being taken into account under section 130 with respect to the qualified assignment; and

(4) the annuity contract or obligation is purchased by the assignee not more than 60 days before the date of the qualified assignment and not later than 60 days after the date of such assignment.

.05 Section 468B(d)(2) of the Code defines a "designated settlement fund" as any fund:

(1) that is established pursuant to a court order and that extinguishes completely the transferor's tort liability with respect to claims arising out of personal injury, death, or property damage;

(2) with respect to which no amount may be transferred other than in the form of qualified payments;

(3) that is administered by persons a majority of whom are independent of the transferor;

(4) that is established for the principal purpose of resolving and satisfying present and future claims against the transferor (or any related person or formerly related person) arising out of personal injury, death, or property damage;

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(5) under the terms of which the transferor (or any related person) may not hold any beneficial interest in the income or corpus of the fund; and

(6) with respect to which an election is made by the transferor.

.06 Section 1.468B-1(a) of the regulations provides that a qualified settlement fund is a fund, account, or trust that satisfies the requirements of section 1.468B-1(c). Section 1.468B-1(c) provides that a fund, account, or trust is a qualified settlement fund if:

(1) it is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

(2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or a related series of events) that has occurred and that has given rise to at least one claim asserting liability:

(a) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. 9601 et seq.; or

(b) arising out of a tort, breach of contract, or violation of law; or

(c) designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

.07 Section 1.468B of the regulations provides that a designated settlement fund is taxed in the manner described in section 1.468B-2, pertaining to qualified settlement funds. In addition, the rules for transferors to a qualified settlement fund described in section 1.468B-3 apply to transferors to a designated settlement fund and the rules for claimants of a qualified settlement fund described in section 1.468B-4 apply to claimants of a designated settlement fund.

.08 Section 1.468B-1(d)(1) of the regulations defines a "transferor" as a person that transfers (or on behalf of whom an insurer or other person transfers) money or property to a qualified settlement fund to resolve or satisfy claims described in section 1.468B-1(c)(2) against that person.

.09 Section 1.468B-3(f)(2)(i) of the regulations provides that, if a qualified settlement fund makes a distribution on behalf of a transferor to a person that is not a claimant, the distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to have made a payment to the actual recipient.

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3. SCOPE

This revenue procedure provides specific guidance on the requirements that must be satisfied in order for a designated settlement fund or qualified settlement fund to be treated as "a party to the suit or agreement" under section 130(c)(1) of the Code. In addition to the requirements provided by this revenue procedure, an assignment by a designated or qualified settlement fund of a liability to make periodic payments must also satisfy all the other requirements of section 130 to be a qualified assignment. No inference should be drawn regarding the application of section 130 to any other type of taxpayer.

This revenue procedure also clarifies that, if the requirements for a "qualified assignment" under section 130 have otherwise been satisfied, no amount will be treated as currently received by a claimant solely because a designated settlement fund or qualified settlement fund is used to hold monies while claimants are being identified and the amounts allocated to each are being determined and/or during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

4. APPLICATION

01. A fund, account or trust that otherwise satisfies the requirements of section 468B(d)(2) in the case of a designated settlement fund or section 1.468B-1(a) of the Income Tax Regulations in the case of a qualified settlement fund does not fail to be a designated settlement fund or a qualified settlement fund solely because the fund, account or trust holds monies that ultimately may be paid for the benefit of a single claimant pursuant to section 130.

02. If each of the following requirements is satisfied, a designated settlement fund or qualified settlement fund will be treated as a "party to the suit or agreement" within the meaning of section 130(c)(1) of the Code, and any periodic payments made by the fund or the ultimate assignee pursuant to a qualified assignment will be treated as excludable from the gross income of the recipient under section 104(a)(2) for purposes of section 130(c)(5) of the Code:

(1) the claimant agrees in writing to the assignee's assumption of the designated or qualified settlement fund's obligation to make periodic payments to the claimant;

(2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) that is either:

(a) a claim described in section 2.04(1) in the case of a designated settlement fund, or

(b) a claim described in section 2.05(2) in the case of a qualified settlement fund;

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(3) each qualified funding asset purchased by the assignee in connection with the assignment by the designated or qualified settlement fund relates to a liability to a single claimant to make periodic payments for damages;

(4) the assignee is not related to the transferor (or transferors) to the designated or qualified settlement fund within the meaning of sections 267(b) or 707(b)(1);

(5) the assignee is neither controlled by, nor controls, directly or indirectly, the designated or qualified settlement fund. For purposes of this section 4.01(5), examples of control include an assignee that is a corporation the stock of which is owned by the fund or an assignee that is a trust the trustee of which is the administrator of the fund; and

(6) the designated settlement fund or qualified settlement fund satisfies the requirements of section 4.03.

.03 A designated settlement fund or qualified settlement fund satisfies the requirements of this section 4.03 if the designated settlement fund or the qualified settlement fund holds monies (i) while the specific claimants and amounts payable to each are being identified and determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments. While the determination as to what constitutes a temporary period will be made on a facts and circumstances basis, an assignment pursuant to section 130 will always be considered to be made within a temporary period with respect to a particular claimant if the assignment occurs within 270 days following the later of: (1) the date on which the settlement between the designated settlement fund or qualified settlement fund and the claimant(s) is executed and (2) the date on which the specific amount payable to each claimant is determined. There is no minimum amount of time that a designated settlement fund or a qualified settlement fund must hold monies.

.04 If an assignment by a designated or qualified settlement fund satisfies the requirements of section 4.02 of this revenue procedure and all the other applicable requirements of section 130 of the Code—

(1) the assignment will be treated as a qualified assignment within the meaning of section 130,

(2) the transferor to the designated or qualified settlement fund will not be treated as receiving a deemed distribution described in section 2.09 of this revenue procedure when the qualified assignment is made,

(3) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies (i) while the specific claimants and amounts payable to each are being identified and determined and/or (ii) during a temporary period while there is being arranged and implemented a

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settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments, and

(4) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies that may ultimately be paid for the benefit of a single claimant.

5. EFFECTIVE DATE

This revenue procedure is effective for qualified assignments made after [Date].

6. EFFECT ON OTHER GUIDANCE

This revenue procedure modifies and supercedes Rev. Proc. 93-34.

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~~Rev. Proc. 93-34, 1993-2 CB 470, 08/10/1993, IRC Sec(s). 468b~~ Revised Rev. Proc. 93-34

1. PURPOSE

This revenue procedure ~~provides rules under which a~~ clarifies that, if the requirements for a "qualified assignment" as described in section 130 of the Internal Revenue Code are otherwise satisfied, no amount will be treated as currently received by a claimant solely because a "designated settlement fund" described in section 468B(d)(2) of the Internal Revenue Code or a "qualified settlement fund" described in section 1.468B-1 of the Income Tax Regulations is used to hold monies (i) while claimants are being identified and the amounts allocated to each are being determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

This revenue procedure modifies and supercedes Rev. Proc. 93-34, which provides rules under which a designated settlement fund or a qualified settlement fund will be considered "a party to the suit or agreement" for purposes of section 130. In general, section 130 provides that an assignee may exclude from gross income amounts it receives for assuming the liability of a party to a suit or agreement to make described periodic payments of damages to a claimant.

2. BACKGROUND

.01 Section 130(a) of the Code provides that any amount received for agreeing to a qualified assignment is not included in gross income to the extent that the amount does not exceed the aggregate cost of any qualified funding assets.

.02 Section 130(c) of the Code defines a "qualified assignment" to mean any assignment of a liability to make periodic payments as damages (whether by suit or agreement) on account of personal injury or sickness (in a case involving physical injury or physical sickness) if:

(1) the assignee assumes the liability from a person who is a party to the suit or agreement;

(2) the periodic payments are fixed and determinable as to the amount and time of payment;

(3) the periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of the payments;

(4) the assignee's obligation on account of the personal injuries or sickness is ~~not~~no greater than the obligation of the person who assigned the liability; and

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(5) the periodic payments are excludable from the gross income of the recipient under section 104(a)(2).

.03 Section 130(c) of the Code provides that the determination of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of the assignment which grants the recipient rights as a creditor greater than those of a general creditor. Under the statute, "a liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor." H.R. CONF. REP. NO. 100-1104 at 171 (1988). The statute also makes clear that "no amount is currently includible in the recipient's income solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor." Id.

.04 Section 130(d) of the Code defines a "qualified funding asset" as any annuity contract issued by a company licensed to do business as an insurance company under the laws of any state, or any obligation of the United States if:

(1) the annuity contract or obligation is used by the assignee to fund periodic payments under any qualified assignment;

(2) the periods of the payments under the annuity contract or obligation are reasonably related to the periodic payments under the qualified assignment, and the amount of any such payment under the contract or obligation does not exceed the periodic payment to which it relates;

(3) the annuity contract or obligation is designated by the assignee as being taken into account under section 130 with respect to the qualified assignment; and

(4) the annuity contract or obligation is purchased by the assignee not more than 60 days before the date of the qualified assignment and not later than 60 days after the date of such assignment.

.~~04~~05 Section 468B(d)(2) of the Code defines a "designated settlement fund" as any fund:

(1) that is established pursuant to a court order and that extinguishes completely the transferor's tort liability with respect to claims arising out of personal injury, death, or property damage;

(2) with respect to which no amount may be transferred other than in the form of qualified payments;

(3) that is administered by persons a majority of whom are independent of the transferor;

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(4) that is established for the principal purpose of resolving and satisfying present and future claims against the transferor (or any related person or formerly related person) arising out of personal injury, death, or property damage;

(5) under the terms of which the transferor (or any related person) may not hold any beneficial interest in the income or corpus of the fund; and

(6) with respect to which an election is made by the transferor.

.~~05~~06 Section 1.468B-1(a) of the regulations provides that a qualified settlement fund is a fund, account, or trust that satisfies the requirements of section 1.468B-1(c). Section 1.468B-1(c) provides that a fund, account, or trust is a qualified settlement fund if:

(1) it is established pursuant to an order of, or is approved by, the United States, any state (including the District of Columbia), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority;

(2) it is established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event (or a related series of events) that has occurred and that has given rise to at least one claim asserting liability:

(a) under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C. 9601 et seq.; or

(b) arising out of a tort, breach of contract, or violation of law; or

(c) designated by the Commissioner in a revenue ruling or revenue procedure; and

(3) the fund, account, or trust is a trust under applicable state law, or its assets are otherwise segregated from other assets of the transferor (and related persons).

.~~06~~07 Section 1.468B of the regulations provides that a designated settlement fund is taxed in the manner described in section 1.468B-2, pertaining to qualified settlement funds. In addition, the rules for transferors to a qualified settlement fund described in section 1.468B-3 apply to transferors to a designated settlement fund and the rules for claimants of a qualified settlement fund described in section 1.468B-4 apply to claimants of a designated settlement fund.

.~~07~~08 Section 1.468B-1(d)(1) of the regulations defines a "transferor" as a person that transfers (or on behalf of whom an insurer or other person transfers) money or property to a qualified settlement fund to resolve or satisfy claims described in section 1.468B-1(c)(2) against that person.

.~~08~~09 Section 1.468B-3(f)(2)(i) of the regulations provides that, if a qualified settlement fund makes a distribution on behalf of a transferor to a person that is not a claimant, the

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distribution is deemed made by the fund to the transferor. The transferor, in turn, is deemed to have made a payment to the actual recipient.

3. SCOPE

This revenue procedure provides specific guidance on the requirements that must be satisfied in order for a designated settlement fund or qualified settlement fund to be treated as "a party to the suit or agreement" under section 130(c)(1) of the Code. In addition to the requirements provided by this revenue procedure, an assignment by a designated or qualified settlement fund of a liability to make periodic payments must also satisfy all the other requirements of section 130 to be a qualified assignment. No inference should be drawn regarding the application of section 130 to any other type of taxpayer.

This revenue procedure also clarifies that, if the requirements for a "qualified assignment" under section 130 have otherwise been satisfied, no amount will be treated as currently received by a claimant solely because a designated settlement fund or qualified settlement fund is used to hold monies while claimants are being identified and the amounts allocated to each are being determined and/or during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments.

4. APPLICATION

01. A fund, account or trust that otherwise satisfies the requirements of section 468B(d)(2) in the case of a designated settlement fund or section 1.468B-1(a) of the Income Tax Regulations in the case of a qualified settlement fund does not fail to be a designated settlement fund or a qualified settlement fund solely because the fund, account or trust holds monies that ultimately may be paid for the benefit of a single claimant pursuant to section 130.

~~.01 A~~02. If each of the following requirements is satisfied, a designated settlement fund or ~~a~~ qualified settlement fund will be treated as "a party to the suit or agreement" within the meaning of section 130(c)(1) of the Code ~~if each of the following requirements is satisfied~~, and any periodic payments made by the fund or the ultimate assignee pursuant to a qualified assignment will be treated as excludable from the gross income of the recipient under section 104(a)(2) for purposes of section 130(c)(5) of the Code:

(1) the claimant agrees in writing to the assignee's assumption of the designated or qualified settlement fund's obligation to make periodic payments to the claimant;

(2) the assignment is made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) that is either:

(a) a claim described in section 2.04(1) in the case of a designated settlement fund, or

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(b) a claim described in section 2.05(2) in the case of a qualified settlement fund;

(3) each qualified funding asset purchased by the assignee in connection with the assignment by the designated or qualified settlement fund relates to a liability to a single claimant to make periodic payments for damages;

(4) the assignee is not related to the transferor (or transferors) to the designated or qualified settlement fund within the meaning of sections 267(b) or 707(b)(1); ~~and~~

(5) the assignee is neither controlled by, nor controls, directly or indirectly, the designated or qualified settlement fund. For purposes of this section 4.01(5), examples of control include an assignee that is a corporation the stock of which is owned by the fund or an assignee that is a trust the trustee of which is the administrator of the fund~~.~~; and

(6) the designated settlement fund or qualified settlement fund satisfies the requirements of section 4.03.

.03 A designated settlement fund or qualified settlement fund satisfies the requirements of this section 4.03 if the designated settlement fund or the qualified settlement fund holds monies (i) while the specific claimants and amounts payable to each are being identified and determined and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments. While the determination as to what constitutes a temporary period will be made on a facts and circumstances basis, an assignment pursuant to section 130 will always be considered to be made within a temporary period with respect to a particular claimant if the assignment occurs within 270 days following the later of: (1) the date on which the settlement between the designated settlement fund or qualified settlement fund and the claimant(s) is executed and (2) the date on which the specific amount payable to each claimant is determined. There is no minimum amount of time that a designated settlement fund or a qualified settlement fund must hold monies.

.~~02~~04 If an assignment by a designated or qualified settlement fund satisfies the requirements of section ~~4.01~~4.02 of this revenue procedure and all the other applicable requirements of section 130 of the Code~~;~~—

(1) the assignment ~~is~~will be treated as a qualified assignment within the meaning of section ~~130 and~~130,

(2) the transferor to the designated or qualified settlement fund will not be treated as receiving a deemed distribution described in section ~~2.08~~2.09 of this revenue procedure when the qualified assignment is made~~.~~;

(3) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies (i) while the specific claimants and amounts payable to each are being identified and determined

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and/or (ii) during a temporary period while there is being arranged and implemented a settlement utilizing periodic payments to the claimant and a qualified assignment of the liability to make the periodic payments, and

(4) no amount will be treated as currently received by a claimant solely because a designated settlement fund or a qualified settlement fund is used to hold monies that may ultimately be paid for the benefit of a single claimant.

5. EFFECTIVE DATE

This revenue procedure is effective for qualified assignments made after ~~August 10, 1993.~~ [Date].

~~DRAFTING INFORMATION~~

~~The principal author of this~~

6. EFFECT ON OTHER GUIDANCE

This revenue procedure ~~is Linda M. Kroening of the Office of the Assistant Chief Counsel (Income Tax & Accounting)~~modifies and supercedes Rev. ~~For further information regarding this revenue procedure, contact Linda M~~Proc. ~~Kroening at (202) 6229~~3~~-4910 (not a toll-free call).~~ 34.

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STRUCTURED SETTLEMENTS AND SINGLE-CLAIMANT QUALIFIED SETTLEMENT FUNDS: REGULATING IN ACCORDANCE WITH STRUCTURED SETTLEMENT HISTORY

Jeremy Babener *

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INTRODUCTION

In 1982, Congress created a subsidy for a relatively new type of settlement: the structured settlement. Rather than paying plaintiff[1] with a single check of $1 million, defendant pays plaintiff $2 million in increments over the next twenty years. As Congress would later

1. Because some personal injury settlements are made before a law suit is filed, the terms "plaintiffs" and "claimants" will be used interchangeably in this Article. Because the cost of settling is typically borne by a defendant's liability insurance carrier, Barbara D. Goldberg & Kenneth Mauro, Utilizing Structured Settlements, in EVALUATING & SETTLING A PERSONAL INJURY CASE: PLAINTIFFS' AND DEFENDANTS' PERSPECTIVES 31, 35–36 (Practising Law Institute, 2001), the term "defendants" and "liability insurers" will be used interchangeably, unless distinguishing is necessary for a particular topic.

explain, spreading the receipt over a long period of time serves the public interest by preventing a plaintiff from prematurely dissipating that money,[2] and possibly becoming dependent upon the state. Thus, it extended the income tax exclusion of personal injury settlement monies to periodic payments, creating the structured settlement tax subsidy.

In so doing, Congress emphasized the application of two well-established tax doctrines that would withhold tax subsidy eligibility if violated: constructive receipt and economic benefit. Congress made clear that a personal injury plaintiff who obtained such control over their settlement funds would not receive the subsidy's benefit. Thus, Congress established a monetary incentive to sacrifice control and immediate receipt of one's settlement monies.

While the legislation immediately began increasing the use of structured settlements, it became clear, at least early on, that defendants were capturing much of the benefit by the conclusion of settlement negotiations. Though this usurpation may have lessened over time as plaintiff advisors became more knowledgeable about structured settlements, it continues today. During the last decade, plaintiffs have used a new entity to capture more of that benefit: the qualified settlement fund.[3] Plaintiffs agree with defendants on a lump-sum settlement amount, and direct that amount to a qualified settlement fund. Thereafter, plaintiffs can structure a settlement to maximize its benefits, without the conflicting objectives inherent in plaintiff-defendant negotiations. Such a fund can be used over the objection or even without the knowledge of defendants.

Because the use of this fund by single-claimants may break two important tax rules that Congress originally applied to the structured settlement tax subsidy—the constructive receipt[4] and economic bene-

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2. Anecdotal evidence suggests that the vast majority of lump-sum settlement recipients prematurely dissipate their settlement moneys. However, though many have cited to the statistic that 90% of such recipients prematurely dissipate their monies within five years, the statistic has been found to be unsubstantiated. Jeremy N. Babener, Note, Justifying the Structured Settlement Tax Subsidy: The Use of Lump Sum Settlement Monies, 6 N.Y.U. J. L. & Bus. 127 (2009); see Laura J. Koenig, Lies, Damned Lies, and Statistics? Structured Settlements, Factoring, and the Federal Government, 82 Ind. L. J. 809, 810 (2007); Adam F. Scales, Against Settlement Factoring? The Market in Tort Claims Has Arrived, 2002 Wis. L. Rev. 859, 870, 873 (2002).

3. See Part V.B.

4. A taxpayer acquires constructive receipt of monies, though not actually in the taxpayer's possession, once the monies have been set aside for his or her exclusive use and can be drawn upon at any time. Treas. Reg. § 1.451-2(a) (as amended in 1979); see infra note 80.

fit doctrines[5]—it is unclear if such claimants can make use of qualified settlement funds and still access the subsidy. Thus, qualified settlement funds have not been widely used because plaintiffs and their advisors do not want to risk the loss of the structured settlement tax subsidy.

Treasury regulations[6] could cure the ambiguity, but should do so in accordance with structured settlement history, and in the interest of public policy. Letters to the Treasury have been written for and against the approval of single-claimant qualified settlement funds being eligible for the 1982 tax subsidy when establishing structured settlements. At least one law review article has also been written in favor of single-claimant qualified settlement funds.[7] Building on prior work, this Article will demonstrate how Treasury regulations extending structured settlement tax subsidy eligibility to structured settlements produced by single-claimant qualified settlement funds would, if found to violate tax doctrine, only constitute a further step in

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5. A taxpayer acquires the economic benefit of monies when they are unconditionally and irrevocably transferred to him or her, though not necessarily accessible. For example, an employee acquires the economic benefit of an irrevocable contribution to a deferred compensation plan where the plan is vested in the employee and secured against the employer's creditors. See Minor v. United States, 772 F.2d 1472, 1474 (9th Cir. 1985) (citing Rev. Rul. 60-31, 1960-1 C.B. 174, 179); infra note 81 (discussing the well-known Sproull v. Comm'r decision). The doctrine has been called "a limited, technical device, created and advanced by the government in order to collect taxes from cash basis taxpayers as soon as possible." Thomas v. United States, 45 F. Supp. 2d 618, 625 (S.D. Ohio 1999). That court established three elements that, together, trigger economic benefit:

> (1) There must be some fund in which money or property has been placed;
>
> (2) The fund must be irrevocable and beyond the reach of the creditors of the party who transferred the funds to the escrow or trust; and
>
> (3) The beneficiary must have vested rights to the money, with receipt conditioned only on the passage of time.

Id. at 620 (1999) (citing Sproull v. Comm'r, 16 T.C. 244 (1951), aff'd, 194 F.2d 541 (6th Cir. 1952)). The Court stated that a beneficiary's interest in a fund is "'vested' if it is nonforfeitable." Id. at 621 (citing I.R.S. Gen. Couns. Mem. 33,733 (Nov. 21, 1966)).

6. The Secretary of the Treasury, empowered to "prescribe all needful rules and regulations for the enforcement of [the Tax Code]," I.R.C. § 7805(a) (2006), has "delegated much of this rulemaking authority to the I.R.S. Chief Counsel's Office." LEANDRA LEDERMAN & STEPHEN W. MAZZA, TAX CONTROVERSIES: PRACTICE AND PROCEDURE 31 (3d ed. 2009). Thus, while the Treasury Department remains the official source of such regulations, id., this Article alternatively calls for new regulations from the Treasury and the Internal Revenue Service (IRS). Of course, Congress could also act to achieve the same result.

7. Richard B. Risk, Jr., A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant, 23 VA. TAX REV. 639 (2004) [hereinafter Risk, A Case].

an ongoing deconstruction of the constructive receipt and economic benefit doctrines, performed through legislative, administrative, and regulatory action. Moreover, the degradation of these doctrines, at least in the context of single-claimant qualified settlement funds, would serve to fulfill the purpose of the original 1982 legislation, despite the apparent inconsistency. Thus, this Article recommends the issuance of Treasury regulations extending structured settlement tax subsidy eligibility to structured settlements produced by single-claimant qualified settlement funds.

Part I introduces the reader to the use and popularity of structured settlements, explaining how the tax subsidy increases the value of a structured settlement. Part II details the early history of structured settlements, including the 1979 Internal Revenue Service (IRS) rulings and 1982 legislation establishing the tax subsidy. It highlights both the application of the economic benefit and constructive receipt doctrines, as well as the purpose of the 1982 legislation: preventing premature lump-sum dissipation. Part III narrates the subsequent erosion of the constructive receipt and economic benefit doctrines. It details the birth and later implicit approval of "factoring," the selling of structured settlements by former claimants. This section suggests that the erosion of the two doctrines may in fact serve the purpose of the original 1982 legislation. Part IV demonstrates the need for the use of single-claimant funds by elaborating on the methods defendants and their liability insurers have used to minimize settlement costs. This section argues that it is in the interest of public policy to direct the benefits of structuring a settlement away from defendants, and toward plaintiffs, so long as structured settlements are not discouraged. Part V describes how single-claimant qualified settlement funds can be used to capture increased benefits for plaintiff, and argues that the continued erosion of the economic benefit doctrine in relation to structured settlements is consistent with past erosion, and serves the purpose of the original 1982 legislation creating the tax subsidy.

I.
WHAT IS A STRUCTURED SETTLEMENT?

A. A Popular Tool

As early as 1981, structured settlements[8] were being hailed as "the wave of the future."[9] Predictions were made that "social and professional pressure"[10] would require the consideration of structured settlements in negotiations.[11] These predictions were proven out.[12]

By all accounts, structured settlements are being used with great frequency. In a large study of over 1,750 commercial liability bodily injury claims, 12% resulted in structured settlements.[13] Approximately one-third of injured victims offered a structured settlement agree to it.[14] Together, these two pieces of information suggest that

---

8. The Tax Code defines a structured settlement as an arrangement established by
> (i) suit or agreement for the periodic payment of damages excludable from the gross income of the recipient under section 104(a)(2), or (ii) [an] agreement for the periodic payment of compensation under any workers' compensation law excludable from the gross income of the recipient under section 104(a)(1) . . . [where periodic payments are] (i) of the character described in subparagraphs (A) and (B) of section 130(c)(2), and (ii) payable by a person who is a party to the suit or agreement or to the workers' compensation claim or by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with section 130.

I.R.C. § 5891 (2006) (defining the term for purposes of section 5891). Section 130(c)(2) provides, "(A) such periodic payments are fixed and determinable as to amount and time of payment, (B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments." I.R.C. § 130(c)(2)(A)–(B) (2006).

9. Howard Rudnitsky & Jeff Blyskal, Something for Everyone, FORBES, 29, 29 (Jan. 19, 1981) (quoting attorney Fred Levin upon agreeing to a structured settlement worth over $10 million).

10. Structuring Settlements: A Roundtable, 19 TRIAL 70, 80 (Jan. 1983) [hereinafter A Roundtable] (comments of Lawrence Charfoos).

11. Id. By 1983, commentators were projecting that plaintiff attorneys might soon face malpractice suits for not informing their clients of the option. Id. at 79 (comments of Herb Cumming); see also Amy J. Conner, Is Plaintiffs' Lawyer Liable for Not Offering Structured Settlement?, LAW. WKLY. USA, Aug. 6, 2001, at 1, available at http://www.jmwsettlements.com/structured_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf.

12. Christopher R. Gullen, What Attorneys Need to Learn From Grillo v. Pettiete, MICH. B. J., Aug. 2003, at 28 (discussing a legal malpractice settlement for more than $4 million resulting from a former personal injury plaintiff suing the attorney and guardian ad litem, both of whom recommended the acceptance of a cash settlement).

13. INSURANCE SERVICES OFFICE, INC., CLOSED CLAIM SURVEY FOR COMMERCIAL GENERAL LIABILITY: SURVEY RESULTS, 1997, 22 (1997) [hereinafter ISO SURVEY] (finding that nearly 25% of the claims where claimants received over $300,000 involved structured settlements).

14. Tax Treatment of Structured Settlements: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 106th Cong. 38 (1999) (statement of

more than a third of personal injury claimants are offered a structured settlement. So much use amounts to over $6 billion of structured settlement premiums being purchased each year,[15] an estimated 5% of the $130 billion of total annual personal injury settlements.[16] Even the 2008 financial crisis does not appear to have significantly harmed the structured settlement industry.[17] Because structured settlements have been available for over three decades, there are currently two million Americans holding some $100 billion in structured settlements.[18]

Thomas W. Little, Former President of National Structured Settlements Trade Association, on behalf of the NSSTA); Letter from Malcolm Deener, President, NSSTA, to Gregory F. Jenner, Acting Assistant Secretary for Tax Policy, Department of the Treasury, and Donald L. Korb, Chief Counsel, I.R.S. (May 10, 2004), available at http://www.risklawfirm.com/files/DeweyBallentineItrtoSenBaucus06-29-04.pdf [hereinafter NSSTA Letter].

15. Risk, A Case, supra note 7, at 644 n.13 (citing Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003)); cf. Scales, supra note 2, at 882 n.72 (citing Press Release, National Structured Settlements Trade Ass'n, Structured Settlements Industry Reports 19 Percent Surge in Demand During 2001; $6.05B Is Best Year in History (Feb. 5, 2002)). In the past, some have estimated the value to reach some $10 billion, Tax Treatment of Structured Settlements: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means, 106th Cong. 78 (1999) [hereinafter 1999 Hearing] (written statement of J.G. Wentworth, a finance company that purchases and securitizes structured settlements), or even $12 billion. Anthony Riccardi & Thomas Ireland, A Primer on Annuity Contracts, Structured Settlements, and Periodic-Payment Judgments, 12 J. LEGAL ECON. 1, 8 (2002–2003) (citing http://www.nssta.com).

16. See Christopher Sheffield, Evolve Financial Division Ramps Up Marketing to Grow Settlement Business, MEMPHIS BUS. J., Feb. 1, 2008, available at http://birmingham.bizjournals.com/memphis/stories/2008/02/04/story11.html. The study by Towers Perrin reported total tort costs in the United States of $252 billion in 2007. TOWERS PERRIN, 2008 UPDATE OF U.S. TORT COST TRENDS 3, available at http://www.towersperrin.com/tp/getwebcachedoc?webc=USA/2008/200811/2008_tort_costs_trends.pdf. The total incorporates the benefits paid or expected to be paid to third parties, defense costs, and administrative expenses. Id. at 8. Patrick J. Hindert, author of STRUCTURED SETTLEMENTS AND PERIODIC PAYMENTS, suggests that payments to injury victims and their attorneys reached $161 billion in 2006, based on one of the Towers Perrin study principals. Patrick J. Hindert, Structured Settlement Surveys, BEYOND STRUCTURED SETTLEMENTS, Nov. 23, 2008, http://s2kmblog.typepad.com/rethinking_structured_set/2008/11/structured-settlement-surveys.html.

17. Some in the industry believe that the current economic uncertainty and declining investment performance drives more people to consider structured settlements. Telephone Interview with Betty Gregware, Sales Executive, John Hancock Life Insurance Co. (Feb. 29, 2009) [hereinafter Gregware Interview]; E-mail from John McCulloch, Vice President National Marketing Director, EPS Settlement Group, Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 9, 2009, 8:30:59 EST) (on file with author) [hereinafter McCulloch E-mail] (predicting increased use of structured settlements as a result of a "flight to quality").

18. See Press Release, J.G. Wentworth, The #1 Reason Consumers Sell Their Structured Settlements Is to Pay Bills, According to Survey by J.G. Wentworth (Nov.

Unsurprisingly, an industry has spawned and expanded to meet and drive demand. As of 2000, there were approximately 430 full-time structured settlement brokers.[19] As of 2001, more than two dozen insurance companies were selling structured settlement annuities.[20]

Early on, structured settlements faced opposition within the plaintiff attorney field.[21] By 1983, however, some plaintiff attorneys were already initiating structured settlement discussions of their own accord.[22] Currently, they are applauded by plaintiffs, defendants, and brokers alike.[23] The National Structured Settlements Trade Associations (NSSTA) can point to many supporters of structured settlements.[24] For example, Andrew J. Imparato, the President of the American Association of People with Disabilities, said, "[s]tructured settlements are a model benefit for people with disabilities."[25]

Because the tax exemption favors the plaintiff, defendant, and broker,[26] the exemption rarely faces serious scrutiny. Perhaps the most thorough examination, aside from a rare few academic articles, was provided by a sister industry spawned in the 1990s.[27] The "factoring"[28] industry, populated by companies who purchase the future stream of income of a structured settlement annuity from former claimants, was strongly criticized by the structured settlement selling

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4, 2008), available at http://www.jgwentworth.com/About/News/Press/Detail.aspx?i=46 [hereinafter The #1 Reason].

19. Richard B. Risk, Jr., Structured Settlements: The Ongoing Evolution From a Liability Insurer's Ploy to an Injury Victim's Boon, 36 TULSA L.J. 865, 879 (2001) [hereinafter Risk, Structured Settlements].

20. Id. at 878.

21. Vasilios B. Choulos, Structured Settlements: Cure or Curse?, 16 TRIAL 73, 74 (Nov. 1980).

22. A Roundtable, supra note 10, at 72 (comments of Herb Cumming).

23. See Scales, supra note 2, at 887.

24. National Structured Settlements Trade Association, Independent Voices, http://www.nssta.com/i4a/pages/index.cfm?pageid=3291 (last visited Jan. 20, 2009).

25. Id. (quoting Andrew J. Imparato, President, American Association of People with Disabilities).

26. Scales, supra note 2, at 887.

27. Margaret Mannix, Settling for Less: Should Accident Victims Sell Their Monthly Payouts?, U.S. NEWS & WORLD REP., Jan. 25, 1999, at 62; Vanessa O'Connell, Like It Or Lump It: Thriving Industry Buys Insurance From Injured Plaintiffs, WALL ST. J., Feb. 25, 1998, at A1.

28. The term "factoring" was once used as a derogatory term by insurance companies; however, since incorporation into federal law, I.R.C. § 5891 (2006), the term has been increasingly used by purchasing company insiders. Telephone Interview with Matt Bracy, General Counsel, Settlement Capital Corp. (Mar. 12, 2009) [hereinafter Bracy Interview].

industry in the mid and late 1990s.[29] Much of the negative criticism of the structured settlement industry was made during this time.[30]

B. The Typical Structured Settlement

The typical structured settlement is agreed to after a lawsuit has been filed,[31] but before substantial involvement by a judge.[32] Structured settlements vary in value. One large survey found that two-thirds of claims using structured settlements involved "major injuries," averaging a total payout of $408,000.[33] The other one-third percent averaged a total payout of $210,000.[34] However, testimony on behalf of the factoring industry represented that more than half of structured settlement premiums fall below $50,000, and that less than 13% exceed $250,000.[35] In any case, some practitioners suggest that a structured settlement can be created for $10,000 or $20,000,[36] though values as low as $5,000 and $2,700 have been reported.[37] The average stream of periodic payments guaranteed by a structured settlement is for twenty years.[38] However, structured settlements commonly include life-contingent payments as a component.[39]

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29. Risk, Structured Settlements, supra note 19, at 883.

30. See infra Part III.

31. Telephone Interview with Jack L. Meligan, Plaintiff Loyal Settlement Planner, Settlement Professionals Inc. (Feb. 5, 2009) [hereinafter Meligan Interview].

32. E-mail from William L. Neff, Partner, Hogan & Hartson LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 23, 2009, 19:29:04 EST) (on file with author) [hereinafter Neff E-mail, Feb. 23, 2009].

33. ISO SURVEY, supra note 13, at 22.

34. Id.

35. 1999 Hearing, supra note 15, at 17 (statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

36. Leo Andrada, Structured Settlements: The Assignability Problem, 9 S. CAL. INTERDIS. L.J. 465, 468, 472 (2000). Life insurance companies set minimum annuity values. McCulloch E-mail, supra note 17. For example, John Hancock Life has a policy minimum of $10,000. Gregware Interview, supra note 17.

37. Meligan Interview, supra note 31. Meligan cites the $2,700 structured settlement as a one-time occurrence, and $5,000 structured settlements as rare, occurring at his office perhaps once per year. Id. Structured settlements for $20,000 are seen more regularly. Id.

38. 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

39. E-mail from Craig H. Ulman, Counsel to NSSTA to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 16, 2009, 16:06:14 EST) (on file with author) [hereinafter Ulman E-mail, Feb. 16, 2009]. Life contingent payments are periodic payments made to a beneficiary until their death. See generally BLACK'S LAW DICTIONARY (West 8th ed. 2004) (defining "annuity").

Not all of a defendant's payment[40] is typically used to purchase an annuity.[41] On average, half of the payout is transferred as an up-front lump-sum to plaintiff, while the other half is paid through the purchase of an annuity[42] via a structured settlement company.[43] From the latter purchase, a structured settlement broker will typically receive a commission of between 2%[44] and 4%.[45]

Anti-assignment clauses, stipulations in the contract preventing plaintiff from transferring rights to the future stream of income, have often been included in settlement agreements.[46] However, these are not necessarily followed,[47] and some courts choose not to enforce them.[48] The practice of "factoring," selling one's right to receive fu-

40. The cost of the structured settlement is typically borne by a defendant's liability insurance carrier. Goldberg & Mauro, supra note 1, at 35–36.

41. See Thomas C. Downs, Superfund Colloquium: Periodic Payment of Claims: New Hope for CERCLA Settlements?, 8 TUL. ENVTL. L.J. 387 (1995).

42. ISO SURVEY, supra note 13, at 22; Gregware Interview, supra note 17 (making a back-of-the-envelope estimation that, of those settlements with structured components, perhaps 40% to 50% of the total settlement is structured). Structured settlement companies are often subsidiaries of insurance companies. See Dan Luther, Trusts May be Superior to 'Structured Settlements', 129 TRUSTS & ESTATES, 28, 28 (Dec. 1990).

43. As will be seen in the next section, infra Part I.C., the structured settlement company assumes the defendant's liability through novation, and purchases an annuity to make periodic payments to the claimant from a life insurance company. Thus, the structured settlement company can also be referred to as an assignee, having been assigned liability from the defendant. This Article will refer to such a company as a "structured settlement company."

44. Risk, Structured Settlements, supra note 19, at 890.

45. Robert W. Wood, Single-Claimant Qualified (468B) Settlement Funds?, TAX NOTES, Jan. 5, 2009, at 71, 73 [hereinafter Wood, TAX NOTES] (noting that the commission will be paid for by the life insurance company); 1999 Hearing, supra note 15, at 19 (1999) (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers). The standard commission is 4%. E-mail from Patrick J. Hindert, Managing Director, S2KM Ltd. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Sept. 4, 2009, 12:00:15 EDT) (on file with author) [hereinafter Hindert E-mail, Sept. 4, 2009]. However, multiple agents frequently share the 4%, thus reducing any individual agent's take. Id. One commentator notes that such commission sharing can create a conflict of interest, sometimes not disclosed to the structured settlement recipient. Id.

46. Scales, supra note 2, at 902.

47. See Settlement Funding, LLC v. Jamestown Life Ins. Co., 78 F. Supp. 2d 1349, 1364 (N.D. Ga. 1999) (noting that the court was "not convinced that there exists a public policy against the assignability of structured payments to protect the recipients of the payments 'from squandering their benefits'"). But see C.U. Annuity Service Corp. v. Scott Young, 722 N.Y.S.2d 236 (N.Y. App. Div. 2001); Green v. Safeco Life Ins., 727 N.E.2d 393 (Ill. App. Ct. 2000); Liberty Life Assur. Co. of Boston v. Stone Street Capital, Inc., 93 F. Supp. 2d 630 (D. Md. 2000); Singer Asset Finance Co. v. Bachus, 741 N.Y.S.2d 618 (N.Y. App. Div. 2002).

48. Settlement Funding, LLC, 78 F. Supp. 2d at 1364.

ture structured settlement payments, is a common transaction that will be discussed later in Part III. Factoring transactions, and legislative decisions regarding them, have done much to erode the tax doctrines discussed in this Article, as applied to structured settlements.

C. A Tax Subsidy at Work

Structured settlements for personal injury claims are made between parties as an alternative to a lump-sum payment.[49] Rather than a defendant writing plaintiff a check for $1 million, for example, the defendant could agree to pay plaintiff $2 million in installments on a semi-annual or monthly basis over a period of years. Because the defendant possesses the bulk of the amount for those years, and can invest it, more money can be paid out later on. Business defendants incapable of making an immediate high-value payment are also able to keep their doors open by delaying payment. Thus, the configuration of a structured settlement is inherently attractive to certain parties, in certain situations.[50]

However, the tax treatment of the structured settlement renders the arrangement even more attractive, and to both sides.[51] It is said that the $6 billion market for structured settlement annuities "owes its existence almost entirely"[52] to what the Joint Committee on Taxation calls a "tax subsidy." [53] The tax subsidy does this by extending the Tax Code's favored treatment of lump-sum awards and settlements for physical injuries to periodic payments. It has long been true that

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49. Other alternatives, like trusts, exist. See generally Luther, supra note 42.

50. NSSTA can produce countless supporters of the tax subsidy, National Structured Settlements Trade Association, Independent Voices, http://www.nssta.com/i4a/pages/index.cfm?pageid=3291 (last visited Feb. 2, 2009), and many articles have been written listing the advantages. E.g., Dirk Yandell, Advantages and Disadvantages of Structured Settlements, 5 J. LEGAL ECON. 71 (1995).

51. Goldberg & Mauro, supra note 1, at 68; A Roundtable, supra note 10, at 70 (comments of Lawrence Charfoos).

52. Scales, supra note 2, at 895 (citing A Roundtable, supra note 10, at 72 (comments of Charles Krause); 1999 Hearing, supra note 15, at 32–33 (Statement of Timothy J. Trankina, Peachtree Settlement Funding)).

53. JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999); see Meligan Interview, supra note 31 (stating that many fewer structured settlements would occur without the tax exemption); Telephone Interview with Randy Dyer, Former Executive Vice President, NSSTA (Feb. 18, 2009) [hereinafter Dyer Interview] (stating that without the tax exemption, structured settlements would be much less common). But see McCulloch E-mail, supra note 17 (arguing that the long term security and flexibility of structured settlements are stronger reasons for a plaintiff to structure than the tax benefit); Ulman E-mail, Feb. 16, 2009, supra note 39 (noting that additional benefits such as protection against creditor claims and mortality risk might sometimes be more important to claimants).

plaintiffs do not include physical injury awards or settlement monies in gross income for purposes of taxation.[54] Once the plaintiff receives those monies and invests them, however, the gain derived is not exempted from taxation.[55]

However, IRS revenue rulings in the late 1970s, and Congress's enactment of the Periodic Payment Settlement Tax Act of 1982, approved a tax exemption that would allow personal injury money to be invested without incurring taxable earnings. In the 1982 Act, Congress amended section 104(a)(2) of the Tax Code to exclude personal physical injury and sickness damages "whether as lump-sums or as periodic payments."[56] Thus, plaintiffs could receive damages in installment payments, without losing the beneficial tax-exempt status of award or settlement monies.[57]

At the same time, Congress also established section 130, which operated on the defense side corresponding to section 104(a)(2)'s amendment affecting the plaintiff side. Section 130 exempts income

54. T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918).

55. See Rev. Rul. 79-313, 1979-2 C.B. 75 (citing Rev. Rul. 65-29, 1965-1 C.B. 59); Andrada, supra note 36, at 470 (citing Kovacs v. Comm'r, 100 T.C. 124 (1993), aff'd per curiam, 25 F.3d 1048 (6th Cir. 1994), cert. denied, 513 U.S. 963 (1994)); Goldberg & Mauro, supra note 1, at 38; Lawrence A. Frolik, The Convergence of I.R.C. § 104(a)(2), Norfolk & Western Railway Co. v. Liepelt and Structured Settlements: Tax Policy 'Derailed', 51 FORDHAM L. REV. 565, 566 (1983). But see I.R.C. § 103 (2006) (exempting interest on state and local bonds from gross income). Earnings on the award or settlement are taxed regardless of whether the parties calculated the lump-sum value based upon future investment. Frolik, supra, at 575.

56. I.R.C. § 104(a)(2) (2006) (emphasis added) (excluding "the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness"). Treasury regulations define "damages received whether by suit or agreement" to include amounts received, except for workmen's compensation, "through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution." Treas. Reg. § 1.104-1(c) (as amended in 1970). Considerable literature is dedicated to differentiating those types of injury payments that do and do not constitute physical injuries or physical sickness. E.g., Henry E. Smith, Symposium, Liability for Inchoate and Future Loss, 88 Va. L. Rev. 1953 (2002).

57. The exemption for these payments continues even upon plaintiff's death. Goldberg & Mauro, supra note 1, at 38 (citing Rev. Rul. 79-220, 1979-2 C.B. 74). States also hold lump sums and periodic payments to be tax exempt. National Structured Settlements Association, Structured Settlements: Financial Protection During Economic Crisis, Jan. 23, 2009, http://www.nssta.com/files/public/FINANCIAL_SECURITY_HAND-OUT_10-08.pdf. The exclusion affects state income taxes as well as federal. Many states use the federal definition of taxable income for their taxable base. E.g., CAL. REV. & TAX CODE § 17071 (West 2009). At least one state explicitly excludes compensation for personal injuries and sickness. Some states continue to exclude non-physical injuries and sickness. N.J. STAT. ANN. § 54A:6-6 (West 2009).

paid by defendants to structured settlement companies for taking on defendants' liability to make future payments to plaintiff through a "qualified assignment."[58] The income is exempt from tax "to the extent that such amount does not exceed the aggregate cost of any qualified funding assets,"[59] those assets being the annuity purchased to fund plaintiff's future payments.

Thus, a transfer of liability would follow these steps. First a defendant might pay $100,000 to a structured settlement company in consideration for the company assuming liability for plaintiff's future payments. The company pockets $3,000 as a fee, and purchases a $97,000 annuity. Because of section 130, the structured settlement company need only pay income tax on the $3,000 fee.[60]

The benefit to the defendant can be seen in the subsequent step. Defendant businesses can deduct personal injury damages paid as a business expense.[61] Thus, the lump-sum payment defendant makes to a structured settlement company will be immediately deductible.[62] That sum acts as an investment principal, which produces earnings over the future payout period. Neither the defendant, nor the structured settlement company, nor the plaintiff, will ever pay taxes on those earnings.[63] In this way, section 104(a)(2) and section 130 combine to create an incredibly beneficial settlement arrangement option

58. See I.R.C. § 130(a) (2006). A qualified assignment is defined as "any assignment of a liability to make periodic payments as damages . . . [where] such periodic payments are fixed and determinable as to amount and time of payment . . . [and] cannot be accelerated, deferred, increased, or decreased by the recipient of such payments." I.R.C. § 130(c) (2006).

59. See I.R.C. § 130(a) (2006). A qualified funding asset has many requirements, including three particularly substantive ones. First, the investment must be an "annuity contract issued by a . . . licensed . . . insurance company . . . or any obligation of the United States." I.R.C. § 130(d) (2006). Second, the timing and amounts of periodic payments must be "reasonably related," to the timing and amounts of payments owed to the plaintiff. Id.; Andrada, supra note 36, at 483 (citing I.R.C. § 130(d)). And third, the annuity must be purchased within sixty days of the qualified assignment. I.R.C. § 130(d)(4) (2006).

60. See Andrada, supra note 36. See generally I.R.C. § 130 (2006).

61. See Joseph W. Blackburn, Taxation of Personal Injury Damages: Recommendations for Reform, 56 TENN. L. REV. 661, 687 (1989) (citing I.R.C. § 165(a) (1986)); I.R.C. § 162 (2006 & Supp. II 2008).

62. See Andrada, supra note 36, at 482, n.59, 483. The defendant can only deduct the present value of the future stream of income, and not the entire expected output. In Ford Motor Co. v. Comm'r, Ford argued that a deduction of the full nominal value of expected output from twenty structured settlements was proper. Ford Motor Co. v. Comm'r, 102 T.C. 87, 90 (1994). This would have amounted to a nearly $24.5 million deduction. Id. However, the Tax Court ruled in favor of the commissioner, allowing only the deduction of cost of the annuities purchased. See id. at 104–05. The Sixth Circuit affirmed. Ford Motor Co. v. Comm'r, 71 F.3d 209 (6th Cir. 1995).

63. See Andrada, supra note 36, at 482.

from an income tax perspective. Together, they allow a smaller, immediately deductible payment from defendant, to create a larger payout for plaintiff.[64]

Defendant could of course pay the periodic payments to the plaintiff itself, taking an ordinary business deduction for each payment. However, in doing so, plaintiff would remain a mere general creditor.[65] Unfortunately, if defendant becomes insolvent under these conditions, plaintiff would be forced to stand in line with other creditors.[66] Section 130 changes that by encouraging defendants to pay the principal amount to an insurance company, hopefully a responsible one.[67] Thereafter, defendant's financial position is of no concern to plaintiff. Moreover, changes to the Tax Code in 1988 allow for structured settlement payees to have rights beyond those of a general creditor.[68]

Of course, there is another, perhaps more significant benefit to defendants. Defendants and their liability insurers can save anywhere between 10% and 30% by using a structured settlement.[69] This will be discussed in Part III.

Perhaps the simplest way to quantify the value of the tax exemption[70] is to compare the rate-of-return that a lump-sum investment would have to obtain, before taxation, in order to result in the same

64. See id.; JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

65. Risk, Structured Settlements, supra note 19, at 875.

66. Id.

67. Some have also observed that life insurance companies benefit from the tax treatment. 1999 Hearing, supra note 15, at 28 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) ("[A] Life Insurance Company gets to sell their annuity policies at very competitive rates. In turn, they put that money to work on investments earning large returns for themselves which far exceed the rate at which the annuities were placed. . . . It is not difficult to see the large profits the Life Insurance Companies enjoy . . . ."); Rudnitsky & Blyskal, supra note 9, at 29 ("Life Insurance Co. of North America isn't hurting either. Its payments guarantee an 8% return, but with long-term Treasury bonds now selling for 12%, LINA can actually do far better.").

68. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342, 3709–10 (1988).

69. Scales, supra note 2, at 880; see 1999 Hearing, supra note 15, at 28 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting savings of 15% to 20%); Neff E-mail, Feb. 23, 2009, supra note 32 (reporting a generally used estimate of 20% as a value of the tax subsidy).

70. At this point, we assume that defendant pays the same amount to the structured settlement company as it would to the plaintiff in a lump-sum settlement. We do so in order to quantify the entirety of the benefit. However, the benefit is likely shared by both parties. See infra Part IV.

after-tax rate-of-return of a structured settlement annuity.[71] As seen in the table below, a lump-sum settlement recipient in the 28% income tax bracket would have to invest at a 6.94% rate-of-return[72] in order to obtain the earnings that a structured settlement recipient would obtain by using an annuity with a rate-of-return of only 5%.[73]

TABLE 1: COMPARISON OF LUMP-SUM INVESTMENT RATE-OF-RETURN WITH AFTER-TAX RATE OF RETURN FOR STRUCTURED SETTLEMENT ANNUITY[74]

Structured Settlement Internal Rate of Return	15% Tax Bracket	28% Tax Bracket	33% Tax Bracket	35% Tax Bracket
5.00%	5.88%	6.94%	7.46%	7.69%
6.00%	7.06%	8.33%	8.96%	9.23%
7.00%	8.24%	9.72%	10.45%	10.77%
8.00%	9.41%	11.11%	11.94%	12.31%

71. Were a lump-sum to be invested as an annuity, the earnings would be taxed pursuant to section 72. I.R.C. § 72 (2006) ("[G]ross income includes any amount received as an annuity."). The earnings would be taxed according to the tax bracket of the taxpayer. I.R.S. Priv. Ltr. Rul. 2005-37-043 (June 23, 2005) ("Under section 72 of the Internal Revenue Code, any amount received under an annuity contract is taxable as ordinary income except to the extent it represents a return of your previously taxed investment in the contract."); I.R.S. Priv. Ltr. Rul. 2000-30-013 (July 28, 2000) ("In general, section 72 provides that distributions under an annuity contract will be taxed as ordinary income, subject only to reducing the taxable portion of the payments by an amount attributable to the annuitant's investment in the contract.").

72. This assumes that the investment is taxed at the ordinary income tax rate, which would be the case if the taxpayer invested in an annuity. See supra note 71. The table provided is based on investments in a bank's certificate of deposit, or CD. MATT GARRETSON & GUY KORNBLUB, NEGOTIATING AND SETTLING TORT CASES § 18:7 (2009). NSSTA provides a comparison where $100,000 structured settlement and $100,000 lump-sum investment produce similarly scheduled payments. Assume a federal income tax rate of 27%, a state income tax rate of 5%, an equal growth interest rate of 6%, and that the structured settlement pays out $500 per month for living expenses over twenty years. Under that scenario, NSSTA projects that the structured settlement will payout approximately $214,000, while the lump-sum will only net approximately $160,000. National Structured Settlements Trade Association, Taxable Portfolio vs. Tax-Free Structured Settlement, http://www.nssta.com/i4a/pages/index.cfm?pageid=3501 (last visited Jan. 20, 2009).

73. GARRETSON & KORNBLUB, supra note 72, § 18:7. The then president-elect for the trade association in Austin, Texas said that a structured settlement with a 6 or 7% rate-of-return for someone in the 40% tax bracket equates to the same earnings as a taxed rate-of-return at 11%. A Roundtable, supra note 10, at 79 (comments of Herb Cumming); Amy J. Conner, Structured Settlements: The Basics, LAWYERS WEEKLY USA, Aug. 6, 2001, at 2, available at http://www.jmwsettlements.com/structured_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf.

74. GARRETSON & KORNBLUB, supra note 72, § 18:7; 4Structures.com, Taxable Equivalent Yield Chart, http://www.4structures.com/4structures/front/resources/tem-

Even those in the 15% tax bracket can earn an additional 1% interest on investments. Over a period of many years, that amounts to a substantial increase in total wealth. Of course, the exemption is more valuable for those with higher tax rates.[75] However, those in the industry believe that the majority of claimants are net taxpayers.[76] Thus, it can benefit most claimants.

II.
STRUCTURED SETTLEMENTS: BIRTH, SUBSIDY, JUSTIFICATION, AND DOCTRINE

Many point to 1968 as the first year of structured settlements.[77] Not until the late 1970s and early 1980s did the method begin to grow at exponential rates.[78] The increasing use of structured settlements, rather than lump-sum payments, has been called "one of the most striking developments in the tort payment structure."[79]

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plate/resources_tools_taxable-equivalent-yield-structured-settlement.jsp (last visited Apr. 13, 2009) (providing the same statistics as the Garretson treatise, and more). One NSSTA attorney agrees that the table illustrates the increase in value that one can obtain through the tax subsidy. E-mail from Craig H. Ulman, Counsel to NSSTA to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 14, 2009 11:44:22 EDT) (on file with author). However, he correctly observes that the table compares a structured settlement annuity's performance with that of a CD, which cannot produce the same type of scheduled payments. Id. (noting that for this reason the comparison may be "poor"). Of course, the return rates listed may be somewhat high for the current economic climate.

75. See Rudnitsky & Blyskal, supra note 9, at 29 (quoting attorney Fred Levin) (describing how the exemption would prevent a 70% income tax rate from transforming 15% interest earnings on an invested lump-sum into 4.5%).

76. Neff E-mail, Feb. 23, 2009, supra note 32. Contra E-mail from Joseph Tombs, Partner, Amicus Financial Advisors LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (June 10, 2009, 8:57:37 EST) (on file with author) (estimating that 30% of structured settlement recipients actually receive a significant reduction in their future income taxes). One commentator questions such statistics: "Where is the objective proof? Many structured settlement industry 'beliefs' don't square with the facts." Hindert E-mail, Sept. 4, 2009, supra note 45 (citing Babener, supra note 2).

77. See Brian Brown & Lisa Chalidze, Structured Settlements: An Overview, 22 VT. B.J. & L. DIG. 14, 14 (1996); Thomas C. Downs, Superfund Colloquium: Periodic Payment of Claims: New Hope for CERCLA Settlements?, 8 TUL. ENVTL. L.J. 387, 402 (1995) (citing Panel Discussion, Annuities to Settle Cases, 42 INS. COUNS. J. 367, 370–77 (1975)). But see Riccardi & Ireland, supra note 15, at 7 (suggesting that it was only in 1968 that they became "widely used"); Brown & Chalidze, supra, at 14 (suggesting that the structured settlements were merely "given a boost" by the Thalidomide cases).

78. See infra Part II.A.

79. Ellen S. Pryor, Symposium, Liability for Inchoate and Future Loss, 88 VA. L. REV. 1757, 1763 (2002).

This section narrates the beginnings of structured settlements, their initial tax treatment by the IRS, and the subsequent legislation codifying and expanding their favorable treatment. In doing so, the section takes note of the initial belief that the doctrines of constructive receipt[80] and economic applied benefit.[81] These doctrines demand that structured settlement recipients, in order to take advantage of the beneficial tax treatment, not obtain control over the annuities purchased to fund their payments. The importance assigned to these doctrines corresponds with the legislation's presumed, and later declared justification to discourage personal injury claimants from quickly dissipating awards or settlement monies within their control.

Part III will then detail the eventual deconstruction of these two doctrines as applied to structured settlements.

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80. Tax regulations supply a definition of constructive receipt:

> Income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Treas. Reg. § 1.451-2(a) (as amended in 1979) (emphasis added).

81. In Sproull v. Commissioner, the Tax Court found that despite an employee's non-involvement in the creation of a trust that deferred payments from the employer to a later date, the question was only whether "any economic or financial benefit [was] conferred on the employee as compensation." Sproull v. Comm'r, 16 T.C. 244, 247 (1951), aff'd, 194 F.2d 541 (6th Cir. 1952) (citing McEwen v. Comm'r, 6 T.C. 1018 (1947)). The court found that the fund was

> ascertained and paid for by petitioner's employer for his benefit in that year. Petitioner had to do nothing further to earn it or establish his rights therein. . . . No one else had any interest in or control over the monies. The trust agreement contained no restriction whatever on petitioner's right to assign or otherwise dispose of the interest thus created in him.

Id. at 248. Thus, the transfer of funds into the trust was held to be taxable income of the employee. Id. at 247–48. Several court's since have used the Sproull approach. A later Tax Court defined the doctrine: "Under the economic-benefit theory, an individual on the cash receipts and disbursements method of accounting is currently taxable on the economic and financial benefit derived from the absolute right to income in the form of a fund which has been irrevocably set aside for him in trust and is beyond the reach of the payor's debtors." Pulsifier v. Comm'r, 64 T.C. 245, 246 (1975) (citing Sproull, 16 T.C. at 247–48). In 1993, the economic benefit doctrine was applied in a technical advice memo to hold, "a service recipient's creation of a fund in which a service provider has vested rights will result in immediate inclusion of the amount funded in the service provider's gross income." I.R.S. Priv. Ltr. Rul. 93-36-001 (May 12, 1993). Some commentators, however, have argued that the economic benefit doctrine has been eroded through misapplication. See Gordon T. Butler, Economic Benefit: Formulating a Workable Theory of Income Recognition, 27 SETON HALL L. REV. 70, 103, 115 (1996).

A. The Birth and Growth of Structured Settlements

Though commentators have yet to determine who coined the term "structured settlements," many point to a set of Canadian Thalidomide cases,[82] against the drug manufacturer Richardson-Merrill.[83] Plaintiffs argued that the company's sleeping pill caused severe and permanent physical handicaps in the children of women who used it during pregnancy.[84] To settle the case, defendant agreed to make periodic payments to plaintiffs.[85] The subsequent rise of structured settlements in the next decade has been attributed to different triggers. Among them, some point to the increase in personal injury cases,[86] specifically "mass personal injury" cases.[87] As will be seen, the tax treatment was probably the largest factor.

As of 1976, the structured settlement market was worth approximately $5 million.[88] This quickly changed with IRS rulings in 1979 and congressional action in 1982,[89] discussed in Part I.B–C. Over the next quarter century, the structured settlement market grew rapidly.

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82. See Brown & Chalidze, supra note 77, at 14 ("Structured settlements as a means of resolving lawsuits date back to the 1960s, and were given a boost by the massive litigation triggered by the drug thalidomide . . . .").

83. Kenneth K. Keene & Robert J. Ross, Structured Settlements, BUS. INS., Apr. 28, 1980, at 25; Downs, supra note 41, at 402–04 (citing Panel Discussion, Annuities to Settle Cases, 42 INS. COUNS. J. 367, 370–77 (1975)).

84. Downs, supra note 41, at 402 (citing Panel Discussion, Annuities to Settle Cases, 42 INS. COUNS. J. 367, 370–77 (1975).

85. See Brown & Chalidze, supra note 77, at 14.

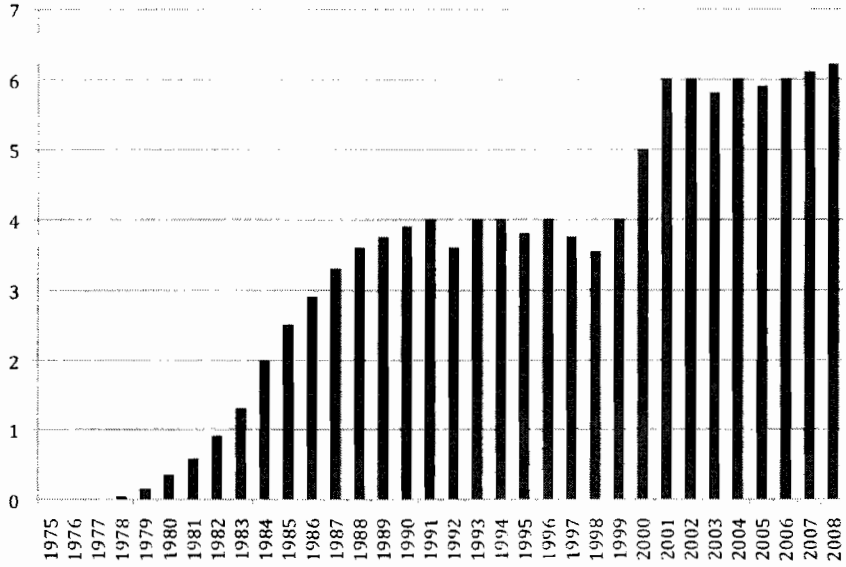
86. REPORT ON PERIODIC PAYMENT OF DAMAGE FOR PERSONAL INJURY AND DEATH, MANITOBA LAW COMMISSION 39 (1987).

87. Andrada, supra note 36, at 467 (citing Brown & Chalidze, supra note 77, at 14).

88. Riccardi & Ireland, supra note 15, at 8.

89. See Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75; Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605, 2605 (1983).

FIGURE 1: STRUCTURED SETTLEMENT ANNUITY SALES IN BILLIONS OF DOLLARS[90]



From $5 million in 1976,[91] and fewer than 3,000 cases in 1979, the market expanded to $1.5 billion in 1983, spread over 15,000 cases.[92] By the early 1990s, twenty life insurance companies were selling structured settlement annuities,[93] and the market had grown to $4 billion.[94] In 1997, a large survey found that 12% of commercial liability physical injury claims settled by way of structured settle-

90. The data was provided by Structured Financial Associates, Inc. E-mail from Melissa Evola, Vice President of Business Development, Structured Financial Associates, Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 27, 2009, 17:19:10 EST) (on file with author) [hereinafter Evola E-mail]. Their data incorporates data through 2002 from a structured settlement treatise, DANIEL W. HINDERT ET AL., STRUCTURED SETTLEMENTS AND PERIODIC PAYMENT JUDGMENTS § 1.03[1] (2009), and has been the treatise's source thereafter. Evola E-mail, supra.

91. Riccardi & Ireland, supra note 15, at 8.

92. Phillip L. Kennerly, Structured Settlements: A Useful Tool for the Claims Judge Advocate, 1986 ARMY L. 12, 12 n.3 (1986) (citing Denninger, Bellamy & Terue, Anatomy of a Structured Settlement, CASE & COMMENT, Feb. 1985, at 26). Other estimates put the value at over $2 billion in 1982. Kennerly, supra, at 128 (quoting Staller, The Basics of Structured Settlements, PRAC. LAW., Jan. 15, 1984, at 75). Some attribute their popularity in the early 1980s, at least in part, to annuities' then impressive double-digit rates-of-return. Risk, Structured Settlements, supra note 19, at 877.

93. Downs, supra note 41, at 403 n.83 (citing Structured Settlements; How to Make Sure You Don't Lose in 'Win-Win' Deals, BUS. INS., Nov. 25, 1991, at 25).

94. Risk, Structured Settlements, supra note 19, at 878.

ments.[95] Nearly 25% of the claims in excess of $300,000 involved structured settlements.[96] Based on the available statistics,[97] the average value of a structured settlement annuity premium is approximately $177,000.

In 2002, NSSTA reported $6.12 billion in annuity premium sales by its members.[98] By 2004, NSSTA estimated that over $400 billion of structured settlement payouts had already been made to 500,000 structured settlement recipients.[99] An organization that has tracked the growth of the industry reports that over 35,000 structured settlement annuities were sold in 2008,[100] accounting for $6.2 billion.[101] Some estimate that more than $100 billion of previously structured settlements currently exist.[102]

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95. ISO SURVEY, supra note 13, at 22.

96. See id. Reportedly, a NSSTA survey found that 7% of settlements between $75,000 and $100,000, and 30% of settlements over $1 million, use structured settlements. Hindert, supra note 16.

97. See Hindert, supra note 16 (providing the estimated total number of structured settlements, which can be used to calculate the average value of structured settlements when combined with the annual value of total structured settlement annuity premiums).

98. Risk, A Case, supra note 7, at 644 n.13 (citing Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003)); cf. Scales, supra note 2, at 882 n.72 (citing Press Release, National Structured Settlements Trade Association, Structured Settlements Industry Reports 19 Percent Surge in Demand During 2001; $6.05B Is Best Year in History (Feb. 5, 2002)).

99. HINDERT ET AL., supra note 90, § 1.03[1] (citing Report of National Structured Settlements Trade Association President Mal Deener to NSSTA Annual Meeting (May 1, 2004)).

100. Evola E-mail, supra note 90. In 2001, 50,000 to 60,000 tort claims were settled using structured settlements. Scales, supra note 2, at 882. It is unclear if that number is accurate, as the author has not found sources tracking the number of sales prior to 2008. If the 50,000 to 60,000 number is accurate, there is a real question of why the number has decreased to 35,000 while the value of sales have increased.

101. Evola E-mail, supra note 90. In the past, some have estimated the value to reach some $10 billion, 1999 Hearing, supra note 15, at 78 (written statement of J.G. Wentworth, a finance company that purchases and securitizes structured settlements), or even $12 billion. Riccardi & Ireland, supra note 15, at 8 (citing http://www.nssta.com). AIG sold the most structured settlement annuities, with nearly $1.5 billion. Evola E-mail, supra note 90. After AIG comes Prudential, with $986 million, MetLife, with $857 million, Hartford, with $767 million, Aviva, with $504 million, John Hancock, with $489 million, New York Life, with $361 million, Allstate, with $280 million, Pacific, with $274 million, Liberty, with $240 million, and Symetra, with $14 million. Id. One treatise notes that the steady volume of structured settlements "indicates a mature market." HINDERT ET AL., supra note 90, § 1.03[1].

102. See, e.g., Daniel W. Hindert & Craig H. Ulman, Transfers of Structured Settlement Payment Rights: What Judges Should Know About Structured Settlement Protection Acts, 44 JUDGES' J. 19, 19 (2005).

It seems to be roundly agreed upon that "[t]he $6,000,000,000 market for structured settlement annuities owes its existence almost entirely to the tax subsidy."[103]

B. The Two Revenue Rulings that Changed Everything

The tax treatment of structured settlements was initially established in 1979.[104] The IRS issued two revenue rulings interpreting section 104(a)(2) in relation to structured settlements, Rev. Rul. 79-220,[105] and Rev. Rul. 79-313.[106] Each allowed the exclusion of periodic payments for personal injury settlements.[107]

Rev. Rul. 79-220 permitted a plaintiff to exclude from income the nominal value of periodic settlement payments when received, rather than their discounted present value at the time of the settlement.[108] In deciding, the ruling took specific note of the fact that the settlement did not give any rights to the plaintiff in the annuity purchased by defendant's insurer.[109] Ultimately, the plaintiff neither had "actual [n]or constructive receipt [n]or the economic benefit of the lump-sum amount that was invested to yield [the monthly settlement payments]."[110] The ruling likened the situation to that of an employer providing deferred compensation.[111] There as well, "the arrangement [is] merely a matter of convenience to the obligor and [does] not give the recipient any right in the annuity itself."[112]

Rev. Rul. 79-313 permitted a plaintiff to exclude from income annual payments made pursuant to a settlement agreement, regardless of the fact that the payment amounts increased by a set percentage each year.[113] Of central importance was the fact that the taxpayer had "neither actual nor constructive receipt, nor the economic benefit of the present value of the damages."[114] Having received neither control

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103. Scales, supra note 2, at 895 (citing A Roundtable, supra note 10, at 72 (comments of Charles Krause); 1999 Hearing, supra note 15, at 24–25 (Statement of Timothy J. Trankina, Chief Executive Officer, Peachtree Settlement Funding)); cf. Meligan Interview, supra note 31 (suggesting that fewer structured settlements would occur without the tax benefits).

104. See Riccardi & Ireland, supra note 15, at 8.

105. See Rev. Rul. 79-220, 1979-2 C.B. 74.

106. See Rev. Rul. 79-313, 1979-2 C.B. 75.

107. See Rev. Rul. 79-220, 1979-2 C.B. 74; see Rev. Rul. 79-313, 1979-2 C.B. 75.

108. See Rev. Rul. 79-220, 1979-2 C.B. 74.

109. See id.

110. Id. (emphasis added).

111. See id. (citing Rev. Rul. 72-75, 1972-1 C.B. 127).

112. Id. (citing Rev. Rul. 72-75, 1972-1 C.B. 127).

113. See Rev. Rul. 79-313, 1979-2 C.B. 75.

114. Id. (emphasis added).

nor guaranteed benefit of the future payments, a taxpayer need not include such monies in their taxable income. Thus, again we see the application and significance of the two doctrines.

C. Codification and More

Structured settlements increased in usage after 1979, as noted, but defendants purchasing annuities to make the periodic payments were only able to deduct those payments as business expenses as the money was distributed to plaintiffs.[115]

In an attempt to alter this disadvantageous position, and thus make structured settlements more attractive to casualty and liability insurers, IBAR Inc. hired a lobbyist, David M. Higgins, a Los Angeles tax attorney, to persuade Congress to enact legislation providing such a deduction.[116] Mr. Higgins worked with the IRS to draft such a law, as well as the Congressional Budget Office.[117] The bill was intro-

115. See Risk, Structured Settlements, supra note 19, at 873–74.

116. Id. at 874. IBAR Settlement Co., Inc. was advised that even if the legislative attempt failed, it would show that there had been a good faith effort to clarify the issue. E-mail from Stan Schultz, CEO, IBAR Settlement Co., Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 27, 2009, 21:05:01 EST) (on file with author) [hereinafter Schultz E-mail].

117. Risk, Structured Settlements, supra note 19, at 874. IBAR first approached Congressman Barry Goldwater, Jr. Schultz E-mail, supra note 116. However, Congressman Goldwater, Jr. was soon embroiled in a drug scandal. Id. See generally House Drug Query Is Assailed, N.Y. TIMES, Nov. 19, 1983, at § 1. Thereafter, IBAR hired the firm of Manett, Phelps, and Phillips, which provided former Congressman James Corman to lobby the "IBAR Bill." Schultz E-mail, supra note 116. At the same time, a group of structured settlement brokers attempted to secure a private letter ruling on similar issues. Id. Though they were advised by the IRS to withdraw the request, they did not. Id. Thereafter, an adverse private letter ruling was issued. Id.; see I.R.S. Priv. Ltr. Rul. 82-48-073 (Aug. 31, 1982). Interestingly, a private letter ruling issued two years prior had already secured the substance of what the 1982 ruling decided against, and what the subsequent legislation would soon codify. See I.R.S. Priv. Ltr. Rul. 80-38-044 (June 24, 1980) (finding a transfer of funds to a structured settlement company equivalent to a loan transaction, and thus not taxable). Though there was no opposition to the original contents of the bill, its many unrelated amendments prevented passage in its first form as the Periodic Payment Settlement Act of 1981. Schultz E-mail, supra note 116. In fact, it was referred to in Congress as "The Christmas Tree Bill," an initially uncontroversial bill that attracted amendments because congressmen believed it would pass. Id. Before passing H.R. 5470 on October 1, 1982, 128 CONG. REC. S26,905 (1982) (statement of the Presiding Officer), the Senate attached to it five "nongermane amendments." 128 CONG. REC. H30,352 (1982) (statement of Rep. Rostenkowski) (noting amendments concerning the Highway Trust Fund, the Hawaiian Prepaid Health Care Act, and tax-related amendments concerning foster care payments, Indian tribal governments, and income in the Virgin Islands). Before submitting the bill to Conference, the House attached a non-germane amendment of its own. 128 CONG. REC. H30,352 (1982) (clarifying government responsibilities in regulating "multiemployer health trusts"). The Conference report, agreed to by both houses soon after its release, 128 CONG. REC. H33,263

duced separately by several legislators.[118]

The Periodic Payment Settlement Tax Act of 1982 codified the two 1979 revenue rulings[119] by amending section 104(a)(2), but went further, creating section 130.[120] Interestingly, Congress avoided providing substantive justifications.[121] Moreover, Congress repeated its evasion when amending the law in 1988,[122] 1996,[123] and 1997.[124]

The Periodic Payment Settlement Tax Act of 1982 codified what the previous revenue rulings provided, replacing section 104(a)(2)'s personal injury exclusion language of "whether by suit or agreement" with "whether by suit or agreement and whether as lump sums or as periodic payments."[125] Reports by the Senate Finance Committee and House Committee on Ways and Means cited the benefit to taxpayers of providing "statutory certainty,"[126] even though parallel revenue rulings already existed. They also stated that the provision was "intended to codify, rather than change, present law . . . [and that] periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer is not in constructive re-

(1982); 128 CONG. REC. S33,183 (1982), cut the House's amendment and two of the Senate's amendments, but generally agreed to the remaining three. See H.R. REP. NO. 97-984, at 13–21 (1982) (Conf. Rep.); see also 128 CONG. REC. H33,263 (1982) (statement of Rep. Rostenkowski) (referring to the Senate amendments respecting Indian tribal governments, the Hawaiian Prepaid Health Care Act, and the tax treatment of particular foster care payments). After trimming and passage, President Reagan intended to veto the bill. See Schultz E-mail, supra note 116 (recalling that the Indian tribal governments amendment was of concern to the President). However, former Congressman James Corman lobbied House Speaker Tip O'Neil, who successfully lobbied the President. Id. Thus, the "IBAR Bill" was signed into law. Id.

118. H.R. 5470 was substantively identical to H.R. 4356, introduced by Congressmen Goldwater and Rousselot, and H.R. 5732, introduced by Congressman Holland. JOINT COMM. ON TAXATION, 97TH CONG., DESCRIPTION OF TAX BILLS (H.R. 4467, H.R. 4948, H.R. 5177, H.R. 5470, AND H.R. 5573 12 n.1 (Comm. Print 1982)). H.R. 4356 and H.R. 5732, unlike H.R. 5470, would have taken effect earlier. Id.

119. See Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75; see also JOINT COMM. ON TAXATION, 97TH CONG., DESCRIPTION OF TAX BILLS (H.R. 4467, H.R. 4948, H.R. 5177, H.R. 5470, AND H.R. 5573 12-13) (Comm. Print 1982).

120. See generally Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, 96 Stat. 2605.

121. See id.; see also S. REP. NO. 97-646 (1982).

122. See Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079, 102 Stat. 3709 (1988).

123. See Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605, 110 Stat. 1755, 1838 (1996); see also H.R. REP. NO. 104-586 (1996).

124. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 962(a), 111 Stat. 788, 891 (1997).

125. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605 (emphasis added).

126. H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 3 (1982).

ceipt of or does not have the current economic benefit of the sum required to produce the periodic payments."[127]

In addition to the codification, the Act inserted section 130 into the tax code, excluding from gross income amounts received by structured settlement companies for accepting a qualified assignment.[128] The addition was passed over certain objections by the Treasury[129] and the life insurance industry.[130]

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127. H.R. REP. No. 97-832, at 4 (1982) (emphasis added); S. REP. No. 97-646, at 3–4 (1982) (emphasis added).

128. See Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(b)(1), 96 Stat. 2605. See generally I.R.C. § 130 (2006). Fifteen years later, in response to lobbying by the National Structured Settlements Trade Association, see Risk, Structured Settlements, supra note 19, at 886 (citing Letter from Legislation and Regulations Committee, NSSTA, to NSSTA Member Companies (Apr. 1997)), the Taxpayer Relief Act of 1997 amended section 130, extending the exemption to worker's compensation payments. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 962(a), 111 Stat. 788, 891 (1997).

129. See Miscellaneous Tax Legislation: Hearings Before the Subcomm. on Select Revenue Measures of the Comm. on Ways and Means, 97th Cong. 7 (1982) [hereinafter 1982 Hearing] (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Treasury Department) (objecting because "[o]ur reading is that it goes beyond existing law"). Because structured settlement annuity earnings would neither be taxable to defendant or plaintiff, Treasury argued that "income slips through the system." Id. at 7. In doing so, Treasury believed the bill to create "a substantial new benefit to third parties that assume obligations to make periodic damage payments." Id. at 14 (written statement of John E. Chapoton). Having heard Treasury testimony, Committee Chairman Pete Stark transitioned to the next witness: "I am sure the gentlemen will now proceed to destroy the testimony of the Secretary of the Treasury. You may proceed to do that in any manner you see fit." Id. at 81 (statement of Pete Stark, Chairman of the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means). IBAR Settlement Co., Inc. lobbyist later responded to the Treasury statements: "I think the Treasury has misread [this] bill . . . I am hopeful we can work out with Treasury their objections because we certainly are not in here looking for anything special. We do not want any excess deductions and we do not want any extraordinary exclusions . . . ." Id. at 88–89 (written statement of David M. Higgins, Esq., Overton, Lyman, & Prince). Interestingly, no one pointed to the previously discussed 1980 private letter ruling holding that monies transferred to a structured settlement company were excludable as the equivalent of a loan transaction. See I.R.S. Priv. Ltr. Rul. 80-38-044 (June 24, 1980). A contrary ruling in 1982 was also not discussed. See I.R.S. Priv. Ltr. Rul. 82-48-073 (Aug. 31, 1982).

130. 1982 Hearing, supra note 129, at 113 (statement of the American Council of Life Insurance) ("Specifically, we are troubled by the provision of the bill which allows such assignees an exclusion from income for amounts received and applied to satisfy assumed damage obligations, yet does not in any way specify when, or how, the assignee must use the amounts received to fund the damage payments . . . . [W]e can see no justification for giving free rein to entities not subject to the rigorous solvency and reserve accounting standards applicable to insurers to provide such statements . . . . For these reasons, we urge that H.R. 5470 be withdrawn, at least insofar as it specifies the tax treatment to be given third party payors of structured annuity damage amounts.").

D. Extrapolating a Justification from the Legislative History

While the committee reports for the Periodic Payment Settlement Tax Act of 1982 convey little about Congress's preference between structured settlements and lump-sum settlements, allowing for both, legislative history of the Act's 1981 predecessor and the 1982 Act's committee hearing provide insight. Concern for the "Squandering Plaintiff,"[131] one who accepts a lump-sum and prematurely dissipates it, was frequently cited. The justification fits well alongside the reference to the constructive receipt and economic benefit doctrines, which require that a claimant not control received settlement monies. By preventing such control, premature dissipation becomes difficult, if not impossible.

Prior to introducing the Periodic Payment Settlement Tax Act of 1982,[132] Senator Max Baucus[133] introduced a very similar Periodic Payment Settlement Act of 1981.[134] Senator Baucus argued that the lump-sum settlement approach "has proven unsatisfactory . . . in many cases because it assumes that injured parties will wisely manage large sums of money so as to provide for their lifetime needs. In fact, many of these successful litigants, particularly minors, have dissipated their awards in a few years and are then without means of support."[135] In contrast, he went on, structured settlements "provide plaintiffs with a steady income over a long period of time and insulate them from pressures to squander their awards."[136]

One year later, in Committee hearings on the bill for the 1982 Act, similar assertions of plaintiff irresponsibility were introduced by Patrick J. Hindert,[137] the later author of a leading structured settlement

131. See Scales, supra note 2, at 869 (discussing this oft-cited argument).

132. See 144 CONG. REC. S11, at 499–01 (1998) (statement of Sen. Baucus).

133. Max Baucus is currently Montana's Senior U.S. Senator, and Chairman of the Senate Finance Committee. See Max Baucus Newsroom, http://baucus.senate.gov/?p=newsroom (last visited Feb. 1, 2009).

134. See The Periodic Payment Settlement Act of 1981, S. 1934, 97th Cong. (2d Sess. 1981).

135. 127 CONG. REC. 30,462 (Dec. 10, 1981) (statement of Sen. Baucus) (introducing the Periodic Payment Settlement Act of 1981).

136. Id.

137. See 1982 Hearing, supra note 129, at 82, 84 (statement of Patrick J. Hindert, President of Benefit Designs, Inc., a consulting firm for personal injury case parties) (testifying that lump-sum plaintiffs "are frequently back on the public dole" due to the dissipation of their award, and that lump-sum recipients are "frequently ill-equipped psychologically, physically or educationally to assume the investment and mortality risks associated with managing money to satisfy anticipated future financial requirements").

treatise,[138] and David Higgins,[139] the attorney hired by IBAR Settlement Co., Inc., to lobby Congress.[140]

The legislative history for the Periodic Payment Settlement Tax Act of 1982 suggests that the prematurely dissipating plaintiff was a, if not the primary, justification for the legislation. This was true even though structured settlement annuities are subject to risks of inflation[141] and insurer failure.[142] Senator Baucus, Mr. Hindert, and Mr. Higgins each suggested that the problem of lump-sum dissipation ex-

138. See generally HINDERT ET AL., supra note 90.

139. See 1982 Hearing, supra note 129, at 87 (written statement of David M. Higgins, Esq., Overton, Lyman, & Prince) ("The use of a periodic payment settlement assures the availability of future compensation for lost support and care as those costs are incurred. Plaintiffs receiving periodic payments truly are protected from their own ill-conceived actions and the advice of others. If a payment or several payments are dissipated, future compensation for future costs continues to be available . . . . The payment of a substantial lump sum often does not mitigate those economic losses in the long run, even if the amounts are theoretically adequate, because few people are capable of investing a large lump sum to assure security, liquidity, and an appropriate rate of return for their future needs. They often are ill-advised by friends, relatives, and even professional managers, and some are natural spend-thrifts in any event.").

140. Telephone Interview with Stan Schultz, CEO, IBAR Settlement Co., Inc. (Apr. 8, 2009).

141. An annuity requires a payee to bind oneself to set future periodic payments. Some have criticized such binding because the plaintiff risks the possibility that inflation will be higher than estimated. See, e.g., Riccardi & Ireland, supra note 15, at 12; see also J. Thomas Romans & Frederick G. Floss, Structured Settlements and the Interest Rate Switch, 12 J. FORENSIC ECON. 57, 60 (1999); Yandell, supra note 50, at 73. If so, the value of the annuity payments decrease, and the annuity cannot be converted into other investments. See Joseph Kelner & Robert S. Kelner, Trial Practice, Variable Income Annuity Structured Settlements, N.Y.L.J., June 27, 2000. Of course, the lack of future knowledge is a "two edged sword." Riccardi & Ireland, supra note 15, at 12. If the rate of inflation is lower than projected, the annuity's payments will have greater value. And, in fact, one study found the internal rates of structured settlements to historically outperform Treasury bill rates 78.52% of the time. See Romans & Floss, supra, at 64. It is unclear what occurs during the remaining 21.48% of the time. See id.

Some structured settlements do not account for inflation at all. See I.R.S. Priv. Ltr. Rul. 94-37-028 (Sept. 17, 1994) (ruling that inflation does not effect the structured settlement tax exemption). This places claimants at far greater risk of increases in inflation. Meligan Interview, supra note 31. One plaintiff-side structured settlement planner recommends not indexing a structured settlement annuity to inflation for clients over forty years of age. Id. This is because an indexed annuity's increasing nominal payments will often not reach the non-indexed payments of decreasing value for over twenty-five years, by which time a claimant will likely not have many years of payments left. Id.

One might ask why Congress allows claimants to risk the loss of their award or settlement by betting on low inflation. Mandating the indexing of structured settlement annuities to inflation might be more in line with the original purpose of the tax subsidy. On the other hand, the fear of the prematurely dissipating plaintiff might have been solely aimed at poor purchasing, not poor investing. This defense will be relevant in the next section as well.

isted, and required a solution. Interestingly, such rhetoric was not included in the committee reports.[143]

E. Congressional Justifications in Hindsight

Though the legislative history suggests that Congress's purpose was to discourage plaintiff lump-sum dissipation, commentators and courts had no congressionally adopted justifications to rely on.[144] Thus, for nearly two decades they hypothesized. Some suggested that periodic payments are excluded simply because personal injury damages are excluded,[145] others that Congress believed structured settlements would prevent plaintiffs from later government dependence.[146]

In 1998 and 1999, however, in the midst of considering how to discourage former plaintiffs from selling their structured settlement without court approval,[147] the justification question was addressed, and largely answered.

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142. One risk inherent to structured settlements is the possibility that the insurer making the periodic payments will not be able to pay, though this has not yet occurred. See Riccardi & Ireland, supra note 15, at 11. Though the 2008 crisis has brought fear and concern about bank security, structured settlements have several protections for payees. National Structured Settlements Association, supra note 57. Such companies must maintain assets above a required reserve ratio, though many reserve more. Id. State regulators retain authority to help move companies toward restructuring in the event of financial insecurity. Id. And, state insurance guaranty associations offer protection somewhat similar to the Federal Deposit Insurance Corporation, making some periodic payments possible if an insurance company stops making payments. Id. However, there are significant limitations in each state preventing insurance agents and brokers from publicly or privately using the existence of guaranty corporations to encourage the use of annuities. See, e.g., N.Y. INS. LAW § 7718 (Consol. 2009). The National Organization of Life & Health Insurance Guaranty Associations keeps a list of the various state statutes. NOLHGA, State Laws and Provisions Report, http://www.nolhga.com/factsandfigures/main.cfm/location/lawdetail/docid/18 (last visited Feb. 9, 2009). It is not clear if guaranty associations will insure factoring companies against life insurance company failures. See Bracy Interview, supra note 28. There has been recent movement toward specifically excluding factoring companies from such protections. See id. Structured settlement planners discuss the possibility of insurer failure with personal injury claimants, but the de minimis risk makes it a very positive discussion. See Meligan Interview, supra note 31.

143. See H.R. REP. NO. 97-832 (1982); S. REP. NO. 97-646 (1982).

144. It seems unlikely that "statutory certainty," see H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 4 (1982), led to the bill's passage. Inserting section 130 was not a codification.

145. Blackburn, supra note 61, at 685.

146. See, e.g., O'Connell, supra note 27; see also Mannix, supra note 27, at 62 ("In 1982, seeking to prevent accident victims from frittering away large sums intended to provide for them over their lifetimes, Congress instituted tax breaks for those who agreed to receive their money over a period of years.").

147. Cf. 1999 Hearing, supra note 15, at 6 (statement of Rep. Pete Stark); 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus).

Industry representatives from both the structured settlement companies and structured settlement purchasing companies agreed that the 1982 legislation was passed in response to the danger of premature lump-sum dissipation.[148] Several congressmen, including those involved in the passage of the original legislation, agreed.[149] Lastly, in describing the basis for what it called Congress's "tax subsidy for the use of structured settlement[s],"[150] the Joint Committee on Taxation report agreed.[151]

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148. 1999 Hearing, supra note 15, at 20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P, on behalf of the National Association of Settlement Purchasers) ("There is no question that one of the reasons motivating [the House Ways and Means Committee on Oversight] to adopt the Periodic Payment Settlement Act of 1982 was that structured settlements are useful in protecting people who cannot protect themselves."); see id. at 37 (statement of Thomas W. Little, Former President of National Structured Settlements Trade Association, on behalf of the NSSTA) ("Congress has adopted special tax rules to encourage and govern the use of structured settlements in order to provide long-term financial security for injured victims and their families.").

149. See id. at 5 (statement of Rep. Pete Stark) ("The stories of people who received large lump-sum settlements and squandered them were equally heart rending, some ended up back on welfare if they were in fact disabled. It made great good sense then, and I think it makes great good sense now."); id. at 6 (statement of Rep. E. Clay Shaw, Jr.) ("Congress was concerned that injured victims would prematurely spend a lump-sum recovery and eventually resort to the social safety net."); 144 CONG. REC. S11,499–01 (1998) (statement of Sen. Baucus) ("[O]ur focus in enacting these tax rules in sections 104(a)(2) and 130 of the Internal Revenue Code was to encourage and govern the use of structured settlements in order to provide long-term financial security to seriously-injured victims and their families and to insulate them from pressures to squander their awards.").

150. JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

151. Id. at 7 ("If a recipient chooses a lump sum settlement, there is a chance that the individual may, by design or poor luck, mismanage his or her funds so that future medical expenses are not met. If the recipient exhausts his or her funds, the individual may be in a position to receive medical care under Medicaid or in later years under Medicare. That is, the individual may be able to rely on Federally financed medical care in lieu of medical care that was intended to have been provided by the personal injury award. Such a 'moral hazard' potential may justify a subsidy to encourage the use of a structured settlement arrangement in lieu of a lump sum payment to the recipient, to reduce the probability that such individuals need to make future claims on these government programs. Under the structured settlement arrangement, by contrast to the lump sum, it is argued that because the amount and period of the payments are fixed at the time of the settlement, the payments are more likely to be available in the future to cover anticipated medical expenses (assuming the payment stream is not transferred by the recipient).") (emphasis added). While the language "may justify" could be interpreted to indicate a lack of commitment by the Joint Committee, the report strongly indicates agreement that the purpose of the subsidy is to prevent dissipation.

Thus, after nearly two decades, Congress had finally clarified the justification for the "tax subsidy" to structured settlement transactions, namely, the image of the squandering plaintiff.[152]

III.
ALLOWING CONSTRUCTIVE RECEIPT AND ECONOMIC BENEFIT

Though Congress's actions and writings discussed thus far highlighted the application of the constructive receipt and economic benefit doctrines to structured settlements, the late 1980s marked the beginnings of a complete overhaul. This section narrates the deconstruction of both doctrines, as applied to structured settlements, through two stages. Congress first legislated a reduced application of the economic benefit doctrine in 1988. Then, in the early 1990s, a new and profitable transaction was discovered whereby a company purchases a structured settlement recipient's future payments, thus conferring the substance of constructive receipt. The IRS and Congress implicitly confirmed recipients' ability to perform such a transfer.

The two changes substantively destroyed much of the constructive receipt and economic benefit doctrines as applied to structured settlements. On the surface, they seem to detract from Congress's initially presumed, now known justification for the structured settlement tax subsidy: the discouragement of personal injury claimants from prematurely dissipating lump-sums. However, though the changes transfer at least some control to the claimant, they leave the tax subsidy's effect intact. As will be shown, they may even have bolstered the subsidy's effectiveness.

A. Congress's U-Turn on Plaintiffs' Need to Avoid Economic Benefit

Though both revenue rulings and legislative history[153] highlight the importance of preventing plaintiffs from receiving the economic benefit of a structured settlement, that limitation was substantially eroded in 1988.[154]

Originally, section 130 stipulated "the assignee does not provide to the recipient of such payments rights against the assignee which are

152. See Scales, supra note 2, at 869 (discussing this oft-cited argument).

153. See H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 4 (1982); Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.

154. See Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A)–(B), 102 Stat. 3342.

greater than those of a general creditor."[155] Thus, a structured settlement recipient was merely a "general creditor"[156] to a structured settlement company, a person to whom the company owed future payments. However, Congress changed the language in 1988 to state, "The determination . . . of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor."[157] Thus, structured settlement plaintiffs can now obtain rights "greater than those of a general creditor."[158]

The new language in the 1988 amendment has been read by the IRS to override the doctrine of economic benefit:

> Generally, the setting aside of funds in trust for recipient confers an economic benefit and results in income to the recipient in the year of setting aside the funds. See Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952). However, the 1988 amendment to section 130(c) of the Code was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments.[159]

The IRS has since held that a plaintiff can hold a security interest in a bank trust created by defendant to fund plaintiff's periodic payments without violating sections 104(a)(2) or 130.[160] Today, some insurance companies offer agreements providing these greater rights, while others do not.[161]

As an explanation for the 1988 amendment, the House Report stated, "Recipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of tax law."[162] Thus, perhaps meaning to, or perhaps not,

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155. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(c)(2)(C), 96 Stat. 2605.

156. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605.

157. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342.

158. Id.

159. I.R.S. Priv. Ltr. Rul. 97-03-038 (Jan. 1, 1997) (emphasis added).

160. Id.; see also I.R.S. Priv. Ltr. Rul. 92-53-045 (Oct. 6, 1992) (holding that section 130 allows a plaintiff to perfect a security interest in a structured settlement annuity contract).

161. E-mail from Betty Gregware, Sales Executive, John Hancock Life Insurance Company to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 27, 2009, 12:47:07 EST) (on file with author).

162. H.R. REP. NO. 100-795, at 541 (1988). See generally H.R. REP. NO. 100-1104, at 25 (1988) (Conf. Rep.).

Congress took a large step away from the economic benefit doctrine as it applies to structured settlements.

Commentators vary in their interpretation of the 1988 switch. One author simply finds the failure to apply the economic benefit doctrine to periodic payments confusing, especially in light of contradictory application of the doctrine in analogous contexts.[163] Another argues that the doctrines of constructive receipt and economic benefit, as applied to structured settlements, should be narrowly construed.[164] At the very least, the 1988 amendment to section 130 allowed the payee of a structured settlement rights that the 1982 House[165] and Senate[166] reports stated would render the received payments ineligible for the favored tax treatment, thus violating the traditional understanding of the economic benefit doctrine.

However, the 1988 legislation did not necessarily contravene Congress's purpose in creating the structured settlement tax subsidy. The new rights available under the amendment can only be accessed under rare circumstances that, in fact, have never transpired.[167] If anything, the amendment assists the tax subsidy, encouraging personal injury claimants to engage in structured settlements by reducing the fear of losing one's settlement monies due to a defendant's bankruptcy. For purposes of this Article the important takeaway is that even early on Congress showed a willingness to relax the doctrine of economic benefit as applied to structured settlements.

B. Eroding Constructive Receipt Through Factoring

Though the 1988 amendment marked a departure from the original application of the economic benefit doctrine to structured settlements, a new transaction developed in the early 1990s that went even further, violating the traditional understanding of the constructive receipt doctrine.[168] The transaction, known as structured settlement

163. Frolik, supra note 55, at 581–82 (citing Rev. Rul. 62-74, 1962-1 C.B. 68 (holding prize payments that would be paid out over two years to be taxable in the year won, despite the fact that the prize money had been deposited into an escrow account prior to the contest); Pulsifier v. Comm'r, 64 T.C. 245, 245–47 (1975) (holding a cash prize taxable in the year won, though it would not be received by the minor winners until the age of majority)). Frolik argues that it seems far more plausible to apply the economic benefit doctrine to structured settlements than prizes not immediately redeemable, especially since structured settlement recipients often play a role in creating the terms and timing of the future payments. Frolik, supra note 55, at 581–582.

164. Risk, A Case, supra note 7, at 652.

165. See H.R. REP. NO. 97-832, at 4 (1982).

166. See S. REP. NO. 97-646, at 4 (1982).

167. Gregware Interview, supra note 17.

168. Scales, supra note 2, at 915.

"factoring," is the sale by a former claimant, now payee, of the right to their structured settlement's future stream of income[169] in exchange for a lump-sum payment.[170] The payee's received lump-sum has since been held to fall under section 104(a)(2), just as if paid in lump-sum form by the original defendant.[171] By offering a cash amount to a structured settlement recipient sufficiently below the present value of the future income stream, a factoring company[172] can net a profit. Commentators have observed that plaintiffs' newfound ability to convert their future structured settlement payments to present value at any time "bespeak[s] 'constructive receipt' of those payments."[173] Thus, in the early 1990s, the creation of the factoring industry tread over

169. The factoring industry reports that the vast majority of factoring transactions are partial purchases, performed by employed structured settlement owners long after the original settlement. 1999 Hearing, supra note 15, at 19–20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, LLP, on behalf of the NASP) (noting that the average seller of a structured settlement had a household income of nearly $25,000).

170. Scales, supra note 2, at 861 (also referring to factoring as "unstructuring"). Insurance companies selling structured settlement annuities frequently place anti-assignment clauses in their contracts. Gregory S. Crespi, Selling Structured Settlements: The Uncertain Effect of Anti-Assignment Clauses, 28 PEPP. L. REV. 787, 789 (2001). Anti-assignment clauses are typically not self-executing. Hindert E-mail, Sept. 4, 2009, supra note 45. A relevant party must act to enforce the clause, though this has become rare since the insertion of section 5891 into the Tax Code. Id. An evolving area of law is the question of whether or not such clauses are effective. See generally HINDERT ET AL., supra note 90, § 16.02[c]; Crespi, supra. However, some observe that anti-assignment clauses are generally not enforced today. See Hindert & Ulman, supra note 102; see Patrick D. Dolan, Securitization of Life Settlements, Structured Settlements and Lottery Awards, in NEW DEVELOPMENTS IN SECURITIZATION 2008 961, 967 (2008) ("Although State Transfer Acts do not explicitly address the enforceability of anti-assignment clauses, the procedures make it much less likely that the transfer will be attacked successfully."). But see C.U. Annuity Service Corp. v. Young, 722 N.Y.S.2d 236, 236–37 (N.Y. App. Div. 2001) ("[T]he promisee did not merely agree that he would refrain from making an assignment; he agreed he was powerless to do so. Having surrendered his legal ability to assign, there was no basis upon which he or any assignee could assert that a purported sale could have any legal effect."); HINDERT ET AL., supra note 90, § 16.02[2] ("[I]n the vast majority of cases, the courts have enforced anti-assignment provisions in structured settlement agreements."). In 1999, it was reported that the insurance industry "routinely file[d] 40 and 50 page briefs and objections to the transfers." 1999 Hearing, supra note 15, at 24 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

171. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999).

172. Though structured settlement recipients typically sell their future stream of income to factoring companies, they could also sell the stream to the original structured settlement company or life insurance company. See Settlement Capital Corp. v. BHG Structured Settlements, Inc., 319 F. Supp. 2d 729, 732 (N.D. Tex. 2004) (concerning a tortious claim where a factoring company lost a purchase of periodic payments from a structured settlement recipient, who decided to transfer her future payments to the annuity-originating structured settlement company instead of the factoring company).

173. Scales, supra note 2, at 915.

Congress's original understanding of section 104(a)(2)'s exclusion limitations.

The factoring market began in the early 1990s.[174] The Settlement Capital Corporation describes itself as the first factoring company.[175] Jim Lokey, the corporation's founder, created the business model after responding to a structured settlement recipient's classified advertisement in a local paper, offering to sell the right to future payments.[176] Soon, other companies entered the market, such as J.G. Wentworth, Peachtree Funding, and Singer Asset Finance.[177] By 1997, at least five major settlement purchasers and many small brokers joined the fray.[178] By 2005, it was estimated that some $250 million of structured settlement payments were purchased annually.[179] J.G. Wentworth, the self-proclaimed "leading direct-to-consumer purchaser of illiquid insurance products issued by highly rated financial institutions in the United States,"[180] reports purchasing structured settlements with aggregate payment streams of $728 million in both 2007 and 2008.[181] Since its inception, the company has completed over 51,000 factoring transactions, with aggregate payment streams of nearly $4 billion.[182] Currently, it is estimated that approximately 8,000 factoring transactions occur annually, with an average price of $45,000, amounting to $360 million.[183] Based on the estimated value

174. Mannix, supra note 27, at 62; O'Connell, supra note 27. But see Settlement Capital Corporation, Structured Settlement Factoring, http://www.setcap.com/structuredfactoring.aspx?pt=services&mCATEGORY_ID=84&SubCATEGORY_ID=84 (last visited Feb. 19, 2010).

175. Settlement Capital Corporation, supra note 174.

176. Scales, supra note 2, at 898 (citing Interview with Earl Nesbitt, Vice President and General Counsel, Settlement Capital Co., in Halladale, Fla. (Oct. 29, 2001)).

177. Scales, supra note 2, at 900. To expand his business, Lokey encouraged structured settlement insurers, consultants, and brokers to refer clients in need of upfront cash to Settlement Capital Corp. Bracy Interview, supra note 28. In doing so, he taught his soon-to-be competitors how to factor. Id.

178. HINDERT ET AL., supra note 90, § 16.02[1] (citing Selling Structured Settlement Payments, NSSTA Newsletter, 3 (Jan. 1998). Other companies, such as Berkshire Hathaway Life Insurance Co., later entered the market. Mannix, supra note 27, at 62. Though there used to be a great many brokers, they are now few and far between. Bracy Interview, supra note 28. Many of the factoring brokerage companies are now factoring companies. Id.

179. See HINDERT ET AL., supra note 90, § 16.02[2].

180. Disclosure Statement: Prepetition Solicitation of Votes with Respect to Prepackaged Plan of Reorganization for JGW Holdco, LLC, J.G. Wentworth, LLC and J.G. Wentworth, Inc. 14 (2009) [hereinafter J.G. Wentworth Disclosure Statement].

181. Id. at 15.

182. Id.

183. E-mail from Earl Nesbitt, Executive Director, NASP, Sept. 11, 2009 to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (on file

of all structured settlements, it is believed that between 5% and 8% of all structured settlements are eventually factored.[184]

Today, a factoring transfer is typically complete three months after a structured settlement recipient first makes contact with the factoring company.[185] Some companies advertise that money can be transferred to recipients within three to six weeks, and even offer cash advances within a few days.[186] Factorers have represented that 88% of structured settlement purchases are "partial purchases,"[187] such that the claimant only sells a portion of his or her future income stream, though J.G. Wentworth has stated that the average factoring customer completes an average of more than two such transactions.[188] According to J.G. Wentworth's[189] Chief Marketing Officer, over 70% of surveyed structured settlement sellers owned their structured settlement for over ten years before factoring.[190]

The factoring market has also fed into securities.[191] In 1997, J.G. Wentworth sold over $140 million of structured settlement securities, paying as much as 7.8% interest per year.[192] Since then, the company has completed nineteen securitizations totaling approximately $2.1 billion.[193] The practice has continued during the 2008 credit crisis,[194] which has been both a boon and a drought to the factoring industry.[195] The reduced availability of credit has driven up business costs, while the downturn has increased consumer demand.[196]

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with author) [hereinafter Nesbitt E-mail, Sept. 11, 2009] (estimating lower numbers for 2009).

184. Id.

185. Bracy Interview, supra note 28.

186. E.g., Seneca One, Getting Started, http://www.senecaone.com/structured-settlement-recipients/getting-started.aspx (last visited Mar. 17, 2009).

187. 1999 Hearing, supra note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers); Telephone Interview with Andrew Cravenho, CEO, Settlement Quotes LLC (Feb. 19, 2009) [hereinafter Cravenho Interview] (stating that structured settlement purchases are typically for most of the guaranteed portion of a structured settlement).

188. J.G. Wentworth Disclosure Statement, supra note 180, at 15.

189. Bracy Interview, supra note 28 (indicating that J.G. Wentworth and Peachtree are, by far, the largest factoring companies in the industry).

190. The #1 Reason, supra note 18 (citing Ken Murray, J.G. Wentworth's Chief Marketing Officer).

191. Andrada, supra note 36, at 472 (citing O'Connell, supra note 27, at A8).

192. O'Connell, supra note 27, at A8.

193. J.G. Wentworth Disclosure Statement, supra note 180, at 23.

194. See J.G. Wentworth – 2, http://s2kmblog.typepad.com/rethinking_structured_set/2008/12/jg-wentworth-2.html (last visited Feb. 6, 2009).

195. See generally J.G. Wentworth Disclosure Statement, supra note 180.

196. Bracy Interview, supra note 28; Cravenho Interview, supra note 187.

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 28 2010

Johnson Regina

From: John Folkl [johnfolkl@yahoo.com]
Sent: Friday, May 28, 2010 11:23 AM
To: Notice Comments
Subject: NOTICE 2010-43 -- SECTION 199 -- TANGIBLE VS. INTANGIBLE PROPERTY

Pursuant to Notice 2010-43, I respectfully submit the following recommendation for inclusion on the 2010-2011 Guidance Priority List.

BACKGROUND

The section 199 deduction is based on Qualified Production Activities Income (QPAI). QPAI includes income from the manufacture in the U.S. and sale or other qualifying disposition of tangible personal property (TPP). Generally, income from intangible property does not qualify for the sec. 199 deduction. The sec. 199 regulations contain a definition of TPP. However, that definition is seriously deficient and does not provide taxpayers the guidance necessary to distinguish tangible from intangible property.

RECOMMENDED GUIDANCE

The definition of TPP should be modified.

DISCUSSION

Reg. 1.199-3(j)(2)(i) defines TPP. In pertinent part, the regulation states "The term **tangible** personal **property is** any **tangible property** other than land, real property described in paragraph (m)(3) of this section, . . . " (emphasis supplied). The words highlighted in the quoted excerpt isolate the core of the purported definition of TPP and reveal there is no definition at all. The highlighted words say "tangible property is tangible property". **This so-called definition of TPP contained in the existing sec. 199 regulations is not a definition, since it provides no explanation regarding the characteristics that make property tangible.**

The regulations' effort at distinguishing intangible property is equally deficient. Reg. 1.199-3(j)(2)(iii) states "The term tangible personal property does not include property in a form other than in a tangible medium. For example, mass-produced books are tangible personal property, but neither the rights to the underlying manuscript nor an online version of the book is tangible personal property." **As in the case with tangible personal property, the regulations do not attempt to explain what characteristics make property intangible.**

A property's character is determined by its essence. *Webster* defines "essence" as "The indispensable or intrinsic properties that characterize or identify something". The synonym paragraph in *Webster* describes the core meaning of essence as "a basic trait or set of traits that defines the character of something". (*Webster's II New College Dictionary*)

What makes property tangible? Simply put, tangible property is physical. A tangible property's essence is physical. Its indispensable, intrinsic characteristics, its traits that define its character, are physical. A piece of land is composed of soil and rock. Its topography may be flat, hilly, swampy, mountainous, or some combination of these qualities. It has a determinate size and a specific location on the planet. These are physical characteristics, and they make a piece of land what it is. A tangible asset's value is inherent in its physical essence.

Conversely, an intangible property's essence is conceptual, not physical. The intrinsic properties that define its character are conceptual, and may be expressed as ideas, formulas, images, or designs. An intangible property's conceptual essence communicates, informs, or instructs. An intangible property's value is inherent in its conceptual essence.

Language is conceptual. A deed to a tract of land uses language to describe location (described as points of

latitude and longitude) and spatial extent (described as boundaries on the north, south, east and west). Patented industrial know-how uses language to provide relevant information (chemical, mechanical, mathematical, etc.) that explains how something is made or how a task is accomplished. The language (i.e., the concepts) contained in the land deed is **purely descriptive** and serves to identify the particular property. On the other hand, the concepts expressed by the patented know-how are **primarily and essentially instructive** and inform the user, explaining how to perform a task. This distinction between descriptive, identifying concepts and instructive, explanatory, communicative concepts correlates with the difference between tangible and intangible assets. **The land's tangibility derives from its physical essence, not its conceptual description. Know-how's intangibility originates from its conceptual essence -- the concepts ARE the know-how.** A drug formula exemplifies the conceptual essence and instructive nature of know-how. The formula embodies the concepts which provide the instructive information enabling either the owner or a licensee to produce the drug.

The U.S. Supreme Court decision in *Diamond v. Chakrabarty,* 447 U.S. 303 (1980) is particularly helpful in comprehending the distinction between tangibles and intangibles. The case involved patent claims with respect to a human-made micro-organism, developed by the inventor to be used in the clean up of oil spills. The patent claims were of three types. The first was a process claim for the method of producing the bacteria. The second involved an inoculum used to apply or spread the organism. The third patent claim was on the bacteria themselves. The patent examiner allowed patents on the first two claims, but denied a patent on the third claim, the claim on the bacteria themselves.

The issue addressed in *Diamond v. Chakrabarty* concerned whether a living organism was patentable. The Court held the organism itself, a bacterium, was patentable. Perhaps unintentionally, **the case illustrated a key distinction between a patented intangible asset and a patented tangible asset.** As stated above, **a patent was awarded on the process claim for the method of producing the organism. The patented process or method was conceptual, instructive, a patented intangible asset that told the user how to make the organism. The organism itself, a bacterium, was a physical thing and therefore a tangible thing. The patented organism was a patented tangible asset.**

As quoted above, the existing sec. 199 regulations identify mass-produced books as tangible property and the rights to the underlying manuscript or an online version of the book as intangible property. However, the regulations do not explain what makes the mass-produced books tangible and the manuscript or online version of the book intangible. **The intangibility of the manuscript and online version of the book is determined by their conceptual essence, reflecting the fact that their content is strictly conceptual (i.e., information). As stated above, language is conceptual, and both a book manuscript and the online version of the book are comprised totally, exclusively of language the purpose or function of which is to communicate or inform. Further evidencing their intangibility, both a book manuscript and an online version of a book can be transmitted by being encoded on radio waves, carried on those waves as information-bearing signals to devices such as computers and converted back into words to be used (i.e., to be read). Tangible, physical property cannot be transmitted as information-bearing signals.**

In the pre-Internet era, before books were used online, the manuscript still performed the instructive role characteristic of an intangible asset. The manuscript of any novel is basically a bunch of words. That bunch of words requires a very specific arrangement in order to perform the intended task of telling the story. The specific arrangement of words that constitutes the manuscript is essentially formulaic, instructive. The identical bunch of words haphazardly arranged does not tell the story. The manuscript tells the user (the publisher) what to print (how to tell the story). It tells the publisher how to use the purely conceptual, informational content of the manuscript to produce something tangible, a book.

Music, films, and computer software share this intangibility. They all consist of information, some type or form of communication or expression, whether in the form of human language, sound, image, or machine language. Each has a conceptual essence, and as a result, each is intangible.

The patented process in *Diamond v. Chakrabarty* was intangible because it was instructive information that enabled a user to produce the organism. The essence of the process consisted of concepts which explained how to make the bacteria. The concepts **were** the process. The patented bacterium, on the other hand, was tangible because the bacterium was strictly a physical organism. Although a conceptual description of the organism may have been contained in the organism patent, nevertheless, the organism's tangibility derived from its physical essence, not its conceptual description.

SUMMARY

As indicated above, the existing sec. 199 regulations contain seriously deficient definitions of tangible and intangible property. The sec. 199 regulations should be modified to reflect the principles discussed above.

If your require further comments, please advise.

John G. Folkl
643 Cannonbury Dr.
St. Louis, MO 63119
(314) 968-1098
(314) 825-8190 (voicemail)

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAY 25 2010

May 12, 2010

Internal Revenue Service
ATTN: CC:PA:LPD:PR (NOTICE 2010-43)
Room 5203
PO Box7604
Ben Franklin Station
Washington, D.C. 20044

Sirs/Ms.,

In response to your notification (IRS) via computer notification requesting ideas to help tax payers, I would like to see a site that provides:

A list of qualified deductions that a retired person may take on their itemized tax forms
A list of qualified deductions that a working person may take on their itemized tax form
In a very clear simple statement so we may complete our tax quickly.
EXAMPLE:
You may list deductions of:

Property tax paid (? All properties you own))
Medical miles driving to see your doctor at (amount) per mile
Charity miles at (amount) per mile (charity means you donate your goods or time free and Receive no pay)
Medical insurance premiums
Other
Other
Other

You must claim as income:
Dividends earned on stocks and investments
Payments from medical insurance paid directly to you
Gains earned from the sale of stock
Interest earned from savings accounts, C.D.'s
Other
Other
Other

I am always afraid I am missing something from either section. I do not do my own taxes, however I list everything for the tax person that does my taxes and he wouldn't know if I missed something, though he is pretty careful about asking if I had one thing or another, but he still wouldn't know if I paid something unless I listed it. This would be very helpful.

Thank you for your attention.

M. J Childs

M.J .Childs
Maj4399@sbcglobal.net

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

MAY 24 2010

May 14, 2010

Internal Revenue Service
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

ATTN: CC: PA: LPD: PR(notice-2010-43) Room 5203

RE: Regulation of Tax Professionals

With specific attention to the INDIVIDUAL PAID TAX PREPARER SMALL BUSINESS

It would be counter productive to charge the same fees for registration, plus a requirement to take expensive Continued Education Courses, to small "schedule C" businesses, preparing less than 75 returns per year, as is charged to CPA's, enrolled agents and lawyers.

Those Professionals charge exorbitant fees to their clients for tax preparation, passing on any increased expense, using their degrees as justification, and their clientele can afford it.

An Individual Paid Tax Preparer's clientele are the low-to-middle-income singles, families, elderly where the cost of a return will range from $50 to $200 and even that is a burden to the tax payer. If we go out of business due to increased expense, it adds to poverty, unemployment, and where does the average citizen go?

SOLUTION:

Keep the Registration Fee very low for PRACTITIONERS WHO DO LESS THAN 75 RETURNS. Provide FREE or LOW-FEE CLASSES using public school facilities throughout the country for us to obtain the 15 hours of continuing professional education required.

Sincerely,

Audrey P Jones

Audrey P. Jones,
4290 Meadow View Dr.
Boynton Beach, Fl. 33436

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

MAY 19 2010

From: amhavel [mailto:amhavel@vermontel.net]
Sent: Wednesday, May 19, 2010 9:52 AM
To: Notice Comments
Cc: amhavel@vermontel.net
Subject: "Notice 2010-43"

hello,
i would like to propose that there be some kind of small organization exclusion when calculating those contributions that come from a disqualified person. for example, a local person wrote a check to us for $5,000 and sierra club $5,000. to sierra club this is a drop in the bucket and would not render this person disqualified. but to us, he becomes disqualified. his intention was the same in both circumstances. help a non-profit's mission in which he believes. it hurts our calculations but does nothing to sierra club's. this seems unjust. why should our status be jeopardized because we are small? this is particularly problematic in the early years, *when having* to do 8734 calculations. we need all the generosity available, but it shouldn't penalize us just because we have small revenue numbers.

thank you for your consideration of this matter.
anne marie havel

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAY 19 2010

May 12, 2010

Rose Marie M. Penalber
5119 St. Albert Drive
Fontana, CA 92336

Internal Revenue Service
Attn: CC: PA: LPD: PR
(Notice 2010-43)
Room 5203
PO Box 7604
Ben Franklin Station
Washington, D. C. 20044

Dear Sir/Mdm,

Re: Subject: IR-2010-024 Dated March 2, 2010 "Who have N0T FILED a 2006 Tax Return".

As a tax preparer how could I do my part help the 2007 taxpayers get their refund? Would IRS be able to pass on to me their names and addresses? I may not be able to reach all of them but at least I can try to reach a few who live in SOUTHERN CALIFORNIA. Would this be possible with your help?

Respectfully yours,

Rose Marie M. Penalber

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAY 17 2010

ALAN H. LEFF, CPA
alanleff@aol.com

5/12/10

DEAR SIR OR MS.

I AM A PRACTICING CPA THE IRS MUST INFORM CONGRESS TO STOP CHANGING THE LAWS FOR AT LEAST 2 YEARS SO THE IRS AND TAX PRACTITIONERS CAN CATCH UP. IT IS LUDICROUS THE LACK OF ~~AFFECT~~ UNDERSTANDING WE GET TO BE ABLE TO DO CAN DO BY THE LAWMAKERS

Alan H Leff CPA

LEFF, KLEIN AND KALFEN, LTD.
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS CONSULTANTS
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Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 17 2010

Johnson Regina

From: Jim Segurson [jimseg1@comcast.net]
Sent: Friday, May 14, 2010 7:18 PM
To: Notice Comments
Subject: Notice 2010-43

Over the past few years we have had Stimulus payments and ERP payments that affected the preparation of tax returns. While the payment of these amounts were confirmed with a notice that also indicated that the amount of the payments were required for preparation of their tax returns, these notices were sent at the time of the payment which was far removed from the time that tax notices (W-2's, 1099's, 1098's) are generally received in January. Consequently these ESP/ERP notices were generally unavailable at the time of tax preparation. In each case Phone/web information lines were required to be setup to obtain this information.

We foresee that this coming tax year that we will have taxpayers that will need to pay their first time homebuyers first loan payment. I hope that the IRS will furnish notices to the affected taxpayers during the normal tax notice period.

IRS should request congress to include provisions, in any bill that results in a taxable benefit or tax deductible expense to taxpayers, that will require government agencies to provide notices to the taxpayer during the normal tax notice period of January in the following year.

Jim Segurson

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 17 2010

Johnson Regina

From: MAllenSanDiego@aol.com
Sent: Friday, May 14, 2010 11:42 AM
To: Notice Comments
Subject: Notice 2010-43

There needs to be a "safe harbor" for shareholders of "S" corporations with regard to the minimum amount of compensation those shareholders are paid. This has been a problem for many, many years. As of this writing it's still a very subjective area of the law, and business owners and their advisors continue to struggle with it in an effort to comply with the law as they interpret it.

Mike Allen
San Diego

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 14 2010

Johnson Regina

From: Glass, Rich [rglass@infinisource.net]
Sent: Friday, May 14, 2010 9:56 AM
To: Notice Comments
Subject: Recommendations for 2010-2011 Guidance Priority List (Notice 2010-43)

To Whom It May Concern:

Infinisource, Inc. would like to provide recommendations for the 2010-2011 Guidance Priority List. This is in response to the request in Notice 2010-43 (www.irs.gov/pub/irs-drop/n-10-43.pdf).

As a benefits and payroll third party administrator, Infinisource assists more than 15,000 employers with compliance issues relating to rules over which IRS has jurisdiction. The following is a list of significant issues on which guidance would be beneficial to many employers:

- **Guidance under §4980B regarding calculation of the applicable premium for COBRA continuation coverage for HRAs.** This law was enacted long before HRAs were effectuated. Employers struggle with making an accurate determination of the correct COBRA premium, particularly with the reasonable actuarial method, which is supposed to take into account "factors as the Secretary [of Treasury] may prescribe in regulations."
- **Application of Michelle's Law to COBRA.** The interaction of these two laws has never been clear, particularly as to when a loss of coverage occurs. Our understanding is that Michelle's Law may have been rendered obsolete by the Affordable Care Act. Confirmation of this fact would be beneficial.
- **Finalization of the Cafeteria Plan Regulations.** There are several questions related to these regulations, including how the substantiation rules apply outside of a debit card context and some questions regarding nondiscrimination testing and the NDT safe harbor. Finalization of these regulations would bring welcome clarity and ensure uniform administration.
- **Potential HIPAA and COBRA Issues for Paying for Individual Coverage Through a Cafeteria Plan.** While the Proposed Cafeteria Plan Regulations allow such payments, it is unclear how and if an employer may be liable under HIPAA (relating to nondiscrimination) and COBRA (if a qualifying event occurs).
- **Dependent Care Assistance Plan Nondiscrimination Testing Rules.** Employers struggle to apply these statutory rules, particularly the 55% Average Benefits Test. Regulatory guidance would enable employers to perform these tests more accurately.

We thank you for your consideration of these issues.

Rich Glass, JD
Chief Compliance Officer
Infinisource, Inc.
866-350-3040, x. 1465
www.infinisource.net

Notice 2010-43

LEGAL PROCESSING DIVISION MAY 14 2010
PUBLICATION & REGULATIONS
BRANCH

Johnson Regina

From: Glauber Kathleen M [Kathleen.M.Glauber@irs.gov]
Sent: Thursday, May 13, 2010 12:47 PM
To: Notice Comments
Subject: Notice 2010-43

The following suggested changes are for the Publication 590, Individual Retirement Arrangements (IRAs):

- On page 41, Worksheet 1-5 , the statement at the top "Use only if you make contributions to a traditional IRA for 2009 and have to figure the taxable part of your 2009 distributions to determine your modified AGI." does not match the information on page 39 under the heading, "Contributions and Distributions in the same year". Please add the words "that may not be fully deductible" to the statement on the worksheet so it reads: "Use only if you make contributions to a traditional IRA for 2009 that may not be fully deductible and have to figure the taxable part of your 2009 distributions to determine your modified AGI."
- On page 51, Worksheet 1-7, provide an example.
- On page 52, in the paragraph under "Recapture tax changes in distribution method under equal payment exception.", it explains to "Report the recapture tax and interest on line 4 of Form 5329." It does not give an explanation on how to compute the interest.
- On page 62, Explain what to do with a Roth contribution/excess contribution returned after the due date (including extensions).
- There is no explanation in the Publication 590 on how to report the 1099-R received with distribution code "T" in box 7. The information on how to report this distribution is only found in the Form 1040 series instructions. (Form 1040 instructions page 24, Form 1040A instructions page 26)

Thank you

Notice 2010-43

MAY 13 2010
PUBLICATION & REGULATIONS BRANCH

Johnson Regina

From: BeneSource@aol.com
Sent: Thursday, May 13, 2010 6:24 AM
To: Notice Comments
Subject: "Notice 2010-43"

To Whom It May Concern:

I would like to verify the small business tax credit under the recently passed Health Care Reform, as follows:

I have read that an employer who is currently deducting the cost of medical insurance as a business expense can **not also have a tax credit on the same amount.**

Since, most if not all small businesses deduct the amount they pay for employee's medical insurance, in effect then they would not be eligible for the tax credit. Please clarify.

Thank you,

Keith J. Bell, CIC
(860) 704-8020 ext. 202
(860) 286-8887 Fax
(860) 716-3089 Cell Phone

American Benefits Alliance
Caring through Action

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LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Notice 2010-43

MAY 12 2010

Johnson Regina

From: Don Baaso [donbaaso@comcast.net]
Sent: Tuesday, May 11, 2010 12:32 PM
To: Notice Comments
Subject: NOTICE 2010-43

W-2, 1098 and 1099 series documents should be in standard formats with the boxes in standard locations and font size mandated. W-2 copy B should be in standard page location.

Donald Baaso
donbaaso@comcast.net

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 12 2010

Johnson Regina

From: Promo Concepts [promoconcepts@cox.net]
Sent: Tuesday, May 11, 2010 6:11 PM
To: Notice Comments
Subject: Notice 2010-43 Recommendations for 2010-2011 Guidance Priority List
Importance: High

Hello,

I was glad to receive the email about submitting recommendations, and I have a request that should be placed at the top of your priority:

According to the US Censes Bureau, there are over 1,000,000 immigrants from Canada, living in the United States, and are legal residents with employment in the USA. I know from speaking with my Canadian colleagues down here that the majority of us have investments and income from Canada, and when it comes time to filing taxes in the US, we receive tax statements from the Canada such as T4 (Canadian Statement of Income) & T3 (Statement of Trust/Investment Income) but it has always been a very difficult task at mapping the T4 & T3 fields to the US 1040. If you would only give us a simple explanation at what to do with each field, it would definitely help the majority of us, and I will definitely pass this on to my Canadian association, I know many of my colleague have this problem. I understand there is a tax treaty between Canada & the USA, where we are not double taxed on income, but it would also be my recommendation to get a general understanding of this treaty without having to understand a complex document, maybe the IRS could have a customer service person that is dedicated to this information and understands the Canada-US treaty tax laws?

I have called the IRS customer service number and they are at a loss on knowing what to do, they all request that I submit the question to the online help, which I have done numerous times but they don't fully understand my request. Even US accountants that are versed on Canadian tax laws do not full understand how to map the T3 & T4 forms correctly.

Thanks,
Phil

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 12 2010

Johnson Regina

From: Bruce or Kay Lassila [bekjl22@yahoo.com]
Sent: Tuesday, May 11, 2010 8:18 PM
To: Notice Comments
Subject: Notice 2010-43

I would like to see the IRS issue guidance regarding self employment income from an LLC where the member is strictly a passive investor. Because the LLC has trade or business income passing through to its members, it has led to confusion whether that income should be considered self employment income or not.

In the case of a restaurant where the LLC managing partner runs the restaurant operation and draws a salary from the restaurant, should the limited partners who have merely put up capital be subject to self employment income on the ordinary business income that passes through to them?

Thank you.

Kay Lassila

Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH
MAY 12 2010

Johnson Regina

From: Craig Vagt [cvagt@tkw.com]
Sent: Tuesday, May 11, 2010 9:07 PM
To: Notice Comments
Subject: Notice 2010-43
Attachments: image001.jpg

I believe that the service needs to clarify and finalize the regulations related to self employment income and limited liability company members. Limited liability companies are the most common ownership structure for business in the country today. There is still significant confusion on when the income allocated to members is subject to SE tax. The question of whether LLC income is subject to SE tax to a member is an example of unsound tax administration. Not only does the uncertainty give rise to many interpretations, but it creates conflicts between partners in the same partnership.

I realize that efforts have been made in the past to clarify the definition with a resulting firestorm of protest from Congress. Given the financial position of the country, maybe the time is ripe to try again.

It is hard to imagine an issue that is less clear, that affects as many entities and individuals as it does and that lies at the heart of one of the country's biggest cash drains has so little attention.

Craig D Vagt, CPA | Partner
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Portland, Oregon 97239 | www.tkw.com
☎: Office 503.274.2849 | 🖷: 503.274.2853 | ✉: cvagt@tkw.com
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Notice 2010-43

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

MAY 12 2010

Johnson Regina

From: Gary E. True [GTrue@summerscomptonwells.com]
Sent: Tuesday, May 11, 2010 11:41 AM
To: Notice Comments
Subject: Notice 2010-43 - Guidance Priority list

It would be very helpful if the IRS would provide guidance on handling estates of decedents dying during 2010 and prior to the reenactment of the estate tax, if that occurs.

For example, there is currently no estate tax, but basis step up is allowed to a limited extend. There is currently no guidance on how to record an election or allocation of basis step up.

Thank you,

Gary True
Summers Compton Wells PC
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St. Louis, Missouri 63124
(314) 872-0331
gtrue@summerscomptonwells.com

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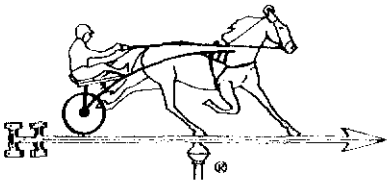

The Hambletonian Society, Inc.

Notice 2010-43

August 30, 2010

SEP 2 3 2010

Internal Revenue Service
Attn: CC:PA:LPD:PR (Notice 2010-43)
1111 Constitution Avenue, N.W.
Washington, DC 20224

LEGAL PROCESSING DIVISION
PUBLICATION & REGULATIONS
BRANCH

Re: Support for Requested Guidance and Inclusion on the 2010-2011 Guidance Priority List

Dear Messrs. Shulman and Wilkins:

Our organization, The Hambletonian Society, is writing to express its strong support for the request submitted on June 11, 2010, by Mr. Thomas A. Davis to include in the Guidance Priority List for 2010-2011 guidance with respect to a change in the definition of "amount wagered" as used in relation to pari-mutuel withholding and reporting under Section 3402(q)(3)(c)(ii) of the Internal Revenue Code of 1986, as amended, and Treas. Reg. section 31.3406(g)-2(d)(3). In addition, The Hambletonian Society supports the specific guidance requested by Attorney Davis, namely, that the term "amount wagered" be defined to include the total amount wagered by the recipient of winning proceeds in a pari-mutuel pool from which such proceeds are paid where the recipient places multiple wagers on the same pool. A copy of the request for inclusion in the Guidance Priority List is attached.

The purpose of The Hambletonian Society is to encourage and support the breeding of Standardbred horses by sponsoring and servicing stakes races and other special events in harness racing, such as the Hambletonian Stakes and the Breeders Crown Championship Series.

Over the past few years, wagering on pari-mutuel horse racing has declined dramatically, from $15.10 billion in 2003 to $12.3 billion in 2009. The pari-mutuel horse racing industry – representing nearly 1,000 off-track wagering service sites and some 200 racetracks – has lost market share as horseplayers migrate to other forms of gambling entertainment that do not withhold on winnings. The current rules are both inequitable and discriminatory in favor of other types of gambling. Changing the definition of "amount wagered" would address this inequity.

Thank you for your consideration of this request. If we may provide any additional information, or answer any questions, please contact me at our office. I remain

Sincerely yours,

Tom Charters
President & C.E.O.

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