TY:

Legend

Assignee =

Parent =

Issuer =

State X =
State Y =
Claimants =

Minor =
Date A =
Date B or Beginning Date =
Date C =
Date D =
Date E =
Date F =
Date G =
Benefit Determination Date =
Court =

Monthly Payment Amounts =
Initial Reference Rate =

Lump Sum Payment =
Assignment Agreement =

Dear :

This letter is in response to the Assignee's request for a letter ruling regarding the application of § 130 of the Internal Revenue Code ("Code") to the transaction described below.

FACTS

Assignee is a State X corporation. Assignee is in the business of assuming periodic payment obligations that it funds through the purchase of annuity contracts. Assignee is a member of an affiliated group of corporations that files a consolidated U.S. federal income tax return, of which Parent is the common parent. Parent files the consolidated return on a calendar year, accrual basis. Parent is a State Y corporation.

Claimants are the legal guardians of Minor. Minor suffered physical injury at birth allegedly because of medical malpractice on the part of the defendant. Claimants made a formal claim against the defendant in which they expressed their intent to file a medical malpractice lawsuit against the defendant. Defendant is covered by medical malpractice insurance issued by a licensed medical malpractice insurance provider ("Insurer").

Defendant, Insurer, and Claimants agreed to settle the dispute and signed a Settlement Agreement and Release dated Date A ("Settlement Agreement"). Under the Settlement Agreement, Claimants agreed to release defendant from any and all claims in exchange for (i) an upfront payment, (ii) a series of payments every two or three years from Date B through Date C, and (iii) another series of deferred payments that are to be paid monthly for twenty years beginning Date B or as a lump sum on Date B depending upon the performance of the 10-year United States Treasury Bond Yield Rate (the payments in (iii) are referred to herein as the "Subject Payments."[1])

The parties agreed that the deferred payments will be paid through two separate structured settlement arrangements funded by annuity contracts intended to be qualified funding assets within the meaning of § 130 of the Code. Insurer was obligated to fund the required payments. Under the Settlement Agreement, the Claimants acknowledge that the deferred payments "cannot be accelerated, deferred, increased or decreased" by the Claimants or Minor, and that neither the Claimants nor Minor has "the power to sell, mortgage, encumber, or anticipate the [deferred payments], or any part thereof, by assignment or otherwise." The Settlement Agreement was approved by order of Court dated Date D.

[1] This ruling request relates only to the structured settlement arrangement involving the Subject Payments.

The Settlement Agreement provides for the Subject Payments to be monthly payments in an amount greater than the Monthly Payment Amounts starting on the Beginning Date and ending Date E. These periodic payments will be made provided that (i) Minor is alive on the Beginning Date, and (ii) the 10-Year United States Treasury Bond Yield Rate ("Reference Rate") is greater than the Initial Reference Rate as of the Benefit Determination Date. If Minor dies before the Beginning Date, or if the Reference Rate is not greater than the Initial Reference Rate, the Settlement Agreement provides for a guaranteed lump sum payment in the amount of Lump Sum Payment to be made on the Beginning Date.

The Initial Reference Rate is the 10-year United States Treasury Bond Yield on Date G. The exact amount of the monthly payment depends on the value of the Reference Rate as of the Benefit Determination Date. If the actual Reference Rate is equal to or less than the Initial Reference Rate as of the Beginning Date, or if the Minor dies before the Beginning Date, Lump Sum Payment will be made on the Beginning Date.

In anticipation of a court-approved settlement, Insurer and Claimants entered into the Assignment Agreement with Assignee effective Date F in connection with the Subject Payments. Under the Assignment Agreement, Insurer agreed to assign, and Assignee agreed to assume, responsibility for the Subject Payments. Claimants released Insurer from all liability to make the Subject Payments. The Assignment Agreement specifically provides that the Subject Payments may not be "accelerated, deferred, increased or decreased, anticipated, sold, assigned, pledged or encumbered" by Claimants. The payments Assignee is required to make under the Assignment Agreement are identical to the Subject Payments.

Assignee purchased the Annuity from Issuer to fund its obligations under the Assignment Agreement. The Annuity is dated Date F. Minor is the measuring life for the Annuity, and Minor is entitled to receive the annuity payments beginning on Date B. The payments under the Annuity are reasonably related to the Subject Payments. Assignee has directed Issuer to make the payments under the Annuity directly to Minor. Under the Assignment Agreement, Assignee agreed to provide Minor with a lien on the Annuity and the payments thereunder to secure Assignee's payment obligations under the Assignment Agreement. Therefore, Annuity bears the following notice:

> The annuity contract has been delivered to the possession of [Minor] for the sole purpose of perfecting a lien and security interest of such persons(s) in this contract. [Minor] is/are not the owner of, and has no ownership rights in this contract and may not anticipate, sell, assign, pledge, encumber, or otherwise use this contract as any form of collateral …

Issuer is in the business of issuing life insurance and annuity contracts. Issuer is taxable as a life insurance company under subchapter L of the Code. The terms of the

Annuity, including the basis for determining the monthly payments were set at the time the Annuity was issued and cannot be changed.

Assignee also makes the following representations:

1. Minor is entitled to damages in the form of periodic payments as a result of personal injury.

2. Amounts payable under the Settlement Agreement will be excludable from Minor's gross income under § 104(a)(2) of the Code relating to physical injury or physical sickness.

3. Pursuant to the Assignment Agreement, Insurer assigned to Assignee, and Assignee assumed from Insurer, the sole responsibility for making Subject Payments to Minor.

4. The obligations of Assignee under the Assignment Agreement are no greater than the obligations of Insurer.

5. Neither Claimants nor Minor will be able to accelerate, defer, increase or decrease the Subject Payments from Insurer or from Assignee.

6. The Annuity qualifies as an annuity under the laws of the state in which it was issued.

7. The Annuity was issued by Issuer to Assignee to fund the Subject Payments due to Minor pursuant to the assignment of a liability to make periodic payments as damages on account of physical injury or sickness (in a case involving physical injury or sickness).

8. The amount of the Subject Payments to Minor and the correlative amount of the payments under the Annuity funding the Subject Payments will be determined taking into account the Reference Rate on the Benefit Determination Date as prescribed by the Settlement Agreement.

9. The periods of the payments under the Annuity issued to Assignee are reasonably related to the periods of the Subject Payments, and the amount of any payment under the Annuity will not exceed the Subject Payment to which it relates.

10. Assignee will designate the Annuity as being taken into account under § 130 of the Code with respect to the transaction entered into pursuant to the Assignment Agreement.

11. The Annuity was purchased by Assignee not more than 60 days before and not later than 60 days after the date of the Assignment Agreement.

12. Except for a small assignment fee, the amount paid to the Assignee for entering into the Assignment Agreement is equal to the purchase price of the Annuity.

RULINGS REQUESTED

The Assignee has requested the following two rulings:

Ruling Request 1: The assignment entered into pursuant to the Assignment Agreement is a qualified assignment under § 130(c) of the Code.

Ruling Request 2: The Annuity is a qualified funding asset under section 130(d) of the Code.

LAW AND ANALYSIS

Section 104(a)(2) of the Internal Revenue Code generally excludes from gross income the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of a personal physical injury or physical sickness.

Section 130(a) provides that the any amount an assignee receives for agreeing to a qualified assignment is not included in gross income to the extent that such amount does not exceed the aggregate cost of any qualified funding assets.

Section 130(c) defines a “qualified assignment” as any assignment of 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 that, among other conditions: such periodic payments are fixed and determinable as to the time and amount of payment,.

Section 130(d) provides the requirements an annuity must meet to qualify as a “qualified funding asset,” including the requirements that (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 (3) the amount of any such payment under the contract or obligation does not exceed the periodic payment to which it relates.

Periodic payments can be fixed and determinable as to the amount and time of payment even if the payments are calculated pursuant to a formula based on the performance of an index and/or a mutual fund portfolio designed to achieve long term growth of capital and moderate current income. Under the facts of this case, the amount and time of the

Subject Payments as determined in accordance with the methodology set forth in the Settlement Agreement and reiterated in the Assignment Agreement depends on the performance of the 10-year United States Treasury Bond Yield or Reference Rate, which is an objective basis for computing the amount of the Subject Payments.

Therefore, we conclude that for purposes § 130(c)(2)(A), Subject Payments are “fixed and determinable” as to the amount and time of payment.

RULINGS

Accordingly, based strictly on the information submitted and the representations made, our office concludes:

1. The periodic Subject Payments of damages that Minor will receive are fixed and determinable as to amount and time of payment within the meaning of § 130(c)(2)(A) even though they are calculated pursuant to an objective formula based on the performance of 10-year United States Treasury Bond Yield Rate. In addition, the other requirements of § 130(c) have also been met. Accordingly, the assignment entered into pursuant to the Assignment Agreement is a qualified assignment under § 130(c).

2. The Annuity purchased by the Assignee qualifies as a qualified funding asset under § 130(d).

CAVEATS:

Except as expressly provided in rulings 1 and 2 above, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no ruling on the taxability of the Subject Payments to Minor has been requested, and therefore no ruling is being issued, under § 104(a)(2) or any other provision of the Code to Minor in this rulings letter. This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by the Assignee and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it (Assignee). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Shareen S. Pflanz
Chief, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

Cc: