

**Office of Chief Counsel
Internal Revenue Service
memorandum**

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to: Alfredo Valdespino
Director, Specialty Examination Policy
(Small Business/Self-Employed)

from: Shareen S. Pflanz
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Office of the Associate Chief Counsel
(Income Tax & Accounting)

subject: Request for PMTA--Structured Settlement Factoring Transactions

This memorandum responds to your request for non-taxpayer specific legal advice with respect to the tax imposed by § 5891(a) of the Internal Revenue Code concerning the three scenarios set forth below. This advice may not be used or cited as precedent.

ISSUES

1. Can the excise tax imposed under § 5891 be asserted against Factor under the facts in Scenario 1 where Factor obtained a court order from a court in a state other than the state of the Payee's domicile, which has a Structured Settlement Protection Act?
2. Can the excise tax imposed under § 5891 be asserted against Factor under the facts in Scenario 2, which are the same as in Scenario 1, except that Factor obtains a court order from a court in the state of Payee's domicile after the transfer of the structured settlement payment rights pursuant to the original court order?
3. Can the tax imposed under § 5891 be asserted against Parent under the facts in Scenario 3, which is the same as in Scenario 1, except that the Parent orders the payments to be directed to Subsidiary? Can the tax also be asserted against Subsidiary?

CONCLUSIONS

1. In Scenario 1, because Factor obtained a court order from a state other than the state of Payee's domicile and the state of Payee's domicile has a Structured Settlement Protection Act, Factor did not obtain a "qualified order" within the meaning of § 5891(b)(2) approving the transfer of the structured settlement payment rights, and therefore the tax imposed by § 5891(a) may be asserted against Factor.
2. In Scenario 2, Factor did not obtain a "qualified order" in advance of the transfer of the structured settlement payment rights but subsequently did obtain a court order from the state of the Payee's domicile after the transfer of the structured settlement payment rights. However, the latter court order did not approve the transfer of such rights "in advance in a qualified order" as required by § 5891(b)(1). The tax imposed by § 5891(a) can be asserted against Factor.
3. In Scenario 3, Parent did not obtain a "qualified order" within the meaning of § 5891(b)(2) approving the transfer of the structured settlement payment rights, and therefore the tax imposed by § 5891(a) may be asserted against Parent. If, for example, upon examination, your office determines that Subsidiary indirectly acquired the structured settlement payment rights or Parent is a shell company, a conduit for the payments to Subsidiary, or is acting as a straw man, then there is support in § 5891(a) for asserting the tax against Subsidiary.

FACTS

Scenario 1:

Payee, an individual, is domiciled in State A. Payee receives a stream of payments from a structured settlement, as defined in § 5891(c)(1) below. After several years of receiving the payments under the structured settlement, Payee decides to sell the future payment rights to Factor, a factoring company. Factor and Payee enter into an agreement pursuant to which Factor will acquire Payee's structured settlement payment rights in exchange for a lump sum.

State A has a Structured Settlement Protection Act (SSPA), which requires that transfers of structured settlement payment rights must receive advance court (or administrative authority) approval in order to be valid. The SSPA meets the requirements for an "applicable state statute" within the meaning of § 5891(b)(3).

Factor does not file a petition to acquire Payee's payment rights in a court in State A, but files the petition in State B. In its petition, Factor represents that Payee is domiciled in State B, despite Payee having been domiciled in State A when the petition was filed, and at all times during the approval process.

In addition, Factor represents to the court that the transfer meets all the conditions found in § 5891(b)(2)(A)(i) and (ii). The State B court approves the transfer of Payee's structured settlement payment rights to Factor, and orders the person funding the structured settlement to redirect the payments to Factor, as transferee. Factor begins to receive payments pursuant to the State B court's order.

Scenario 2:

The facts are the same as the facts in Scenario 1, except that subsequent to the order issued by the court in State B, the Service initiates an examination of Factor's company records to determine any tax liability under § 5891. The Service proposes asserting the tax on the transaction described in Scenario 1 arguing that the structured settlement factoring transaction does not meet the exception to the tax in § 5891(b) because Factor did not obtain a "qualified order" under § 5891(b)(2). In an attempt to remedy the situation, Factor files a petition in a court in State A to approve the transfer pursuant to the original State B court order. The court in State A approves the original transfer. Factor provides the State A court's order to the Service, and argues that the transfer has been approved in a "qualified order" and thus no tax is due.

Scenario 3:

The facts are the same as the facts in Scenario 1, except that Payee decides to sell the future payment rights to Parent, a factoring company. In addition, in its petition to the court in State B, Parent requests that the court approve and order the assignment of the payments to Subsidiary, which is wholly-owned by Parent and finances Parent's factoring transactions. The State B court approves the transfer, and per the request of Parent, orders the person funding the structured settlement to redirect the payments to Subsidiary. Subsidiary begins to receive payments under the structured settlement pursuant to the State B court order.

LAW AND ANALYSIS

Section 5891(a) imposes on any person who acquires directly or indirectly structured settlement payment rights in a structured settlement factoring transaction a tax equal to 40 percent of the factoring discount with respect to such factoring transaction.

Section 5891(b)(1) provides that the tax imposed under § 5891(a) shall not apply to a structured settlement factoring transaction if the transfer of structured settlement payment rights is approved in advance in a qualified order.

Section 5891(b)(2), provides that the term "qualified order" means a final order, judgment, or decree that (A) finds that the transfer of structured settlement payment rights does not contravene any Federal or state statute, or the order of any court or responsible administrative authority, and is in the best interest of the payee, taking into account the welfare and support of the payee's dependents; and (B) is issued (i) under the authority of an applicable State statute by an applicable State court, or (ii) by the

responsible administrative authority (if any) which has exclusive jurisdiction over the underlying action or proceeding which was resolved by means of the structured settlement.

Section 5891(b)(3) provides that for purposes of § 5891, the term “applicable State statute” means a statute providing for the entry of an order, judgment, or decree described in § 5891(b)(2)(A) that is (A) enacted by the State in which the payee of the structured settlement is domiciled, or (B) if there is no such statute, a statute that is enacted by the State in which either the party to the structured settlement (including an assignee under a qualified assignment under section 130) or the person issuing the funding asset for the structured settlement is domiciled or has its principal place of business; and provides for the entry of such an order, judgment, or decree.

Section 5891(b)(4)(A) provides that the term “applicable State court” means, with respect to any applicable state statute, a court of the State that enacted such statute. Under § 5891(b)(4)(B), if the payee of the structured settlement is not domiciled in the State that enacted the statute, the term also includes a court of the State in which the payee is domiciled.

Section 5891(b)(5) provides that a qualified order shall be treated as dispositive for purposes of the exception in § 5891(b).

Section 5891(c)(1) defines the term “structured settlement” to mean an arrangement— (A) which is established by (i) suit or agreement for the periodic payment of damages excludable from the gross income of the recipient under § 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 a character described in § 130(c)(2)(A) and (B); 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 § 130.

Section 5891(c)(2) defines the term “structured settlement payment rights” to mean rights to receive payments under a structured settlement.

Section 5891(c)(3)(A) defines the term “structured settlement factoring transaction” to mean a transfer of 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. Under § 5891(c)(3)(B), “structured settlement factoring transaction” does not include —(A) the creation or perfection of a security interest in structured settlement payment rights under a blanket security agreement entered into with an insured depository institution in the absence of any action to redirect the structured settlement payments to such institution (or agent or successor thereof) or otherwise to enforce such blanket security interest as against the structured settlement payment rights; or (B) a subsequent transfer of structured settlement payment rights acquired in a structured settlement factoring transaction.

Section 5891(c)(4) defines the term “factoring discount” to mean an amount equal to the excess of—(A) the aggregate undiscounted amount of structured settlement payments being acquired in the structured settlement factoring transaction; over (B) the total amount actually paid by the acquirer to the person from whom such structured settlement payments are acquired.

In Scenario 1, Payee is domiciled in State A, and State A has an SSPA, which is an “applicable state statute” within the meaning of § 5891(b)(3). Therefore, in order to qualify for the exception in § 5891(b) from the 40 percent tax imposed by § 5891(a), Factor must obtain a “qualified order” that complies with § 5891(b)(2) from State A, an applicable state court within the meaning of § 5891(b)(4) approving in advance the transfer of Payee’s payment rights to Factor, the factoring company. Factor did not obtain an order from a court in State A pursuant to State A’s SSPA as required by §§ 5891(b)(2) and (3). Instead, Payee obtained an order from a court in State B by misrepresenting to the court the domicile of Payee. The State B court is not an applicable state court under § 5891(b)(4)(A). Accordingly, the order from the court in State B is not a “qualified order” that complies with the requirements of § 5891(b)(2). Consequently, the § 5891(a) excise tax applies against Factor.

The facts in Scenario 2 are the same as in Scenario 1, except that subsequent to the initiation of an examination of Factor by the Service, Factor petitioned the court in State A to approve the original order issued by the court in State B in an attempt to remedy the situation. Although Factor ultimately received an order approving the transfer of Payee’s structured settlement payment rights from a court in State A, the order was obtained after the transfer of the structured settlement payment rights to Factor from Payee pursuant to the order of the State B court.

Section 5891(b)(1) clearly states that the tax imposed under § 5891(a) shall not apply to a structured settlement factoring transaction in which the “transfer of structured settlement payment rights *is approved in advance in a qualified order.*” (Emphasis added). In Scenario 2, it is clear that the order of the court in State A approved the transfer of Payee’s structured settlement payment rights after the transfer of such rights to Factor pursuant to the order issued by the State B court. Consequently, the requirements of § 5891(b)(1) have not been met in Scenario 2, and accordingly, your office can assert the tax against Factor.

Scenario 3 is the same as Scenario 1, except that the court in State B approves the transfer of Payee’s structured settlement payment rights, and per the request of Parent, orders the person funding the structured settlement to redirect the payments to Subsidiary, Parent’s assignee. As in Scenario 1, Payee did not obtain a “qualified order” within the meaning of § 5891(b)(2). Therefore, your office can assert the excise tax against Parent. In addition, there is support in the “directly or indirectly” language in § 5891(a) for asserting the tax against Subsidiary if it is found upon examination that Subsidiary acquired (indirectly) Payee’s structured settlement payment rights. For example, the tax may be asserted against Subsidiary if your office finds that Parent is a shell company or straw man; or that the substance of the transaction is that Subsidiary

indirectly acquired the structured settlement payment rights, then there is support in § 5891(a) for asserting the tax against Subsidiary.

Please call Ed Schwartz or me at (202) 317-7006 if you have any further questions.