IRS CODES

IRS Code Section 61(a) **– Gross Income**

Gross income includes all income from whatever source derived except as otherwise provided by law.

IRS Code Section 1.451-2 **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.

IRS Code Section 104(a) **-Compensation for Physical Injuries and Sickness**

Excludes from their gross income monies received for physical injuries or sickness whether by suit or agreement and whether as lump sums or as periodic payments.

(1) amounts received under workmen's compensation acts as compensation for personal injuries or sickness;

(2) 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...For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness.

* The Periodic Payment Settlement Act of 1982 amended this section to allow the recipient to exclude from gross income all of the payments from a suit or agreement, whether paid all at once or in the future.
** The Small Business Job Protection Act of 1996 inserted the word "physical" into IRC § 104(a)(2) in describing injury or sickness, and removed punitive damages from the exclusion

IRS Code Section 79-220 **–Monthly Payments: Amounts Excludable**

Set the precedents for the tax free treatment of periodic payments under 104 (a)

The exclusion from gross income provided by section 104(a)(2) of the Code applies to the full amount of the monthly payments received by plaintiff in settlement of the damage suit because plaintiff 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 that was invested to yield that monthly payment. If plaintiff should die before the end of the guarantee, the payments made to plaintiff's estate under the settlement agreement are also excludable from income under section 104.

IRS Code Section 72(q) **- Individually-Owned Annuity**

Imposes a 10% premature distribution penalty unless distributions meet one of the requirements:

A made on or after the date on which the taxpayer attains age 591/2,

B. made on or after the death of the holder (or, where the holder is not an individual, the death of the primary annuitant (as defined in subsection (s)(6)(B))),

C. attributable to the taxpayer's becoming disabled within the meaning of subsection (m)(7),

D. which is a part of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the taxpayer or the joint lives (or joint life expectancies) of such taxpayer and his designated beneficiary,

E. from a plan, contract, account, trust, or annuity described in subsection (e)(5)(D), allocable to investment in the contract before August 14, 1982, or [2]

F. under a qualified funding asset (within the meaning of section 130 (d), but without regard to whether there is a qualified assignment),

G. to which subsection (t) applies (without regard to paragraph (2) thereof),

H. under an immediate annuity contract (within the meaning of section 72 (u)(4)), or

I. which is purchased by an employer upon the termination of a plan described in section 401 (a) or 403 (a) and which is held by the employer until such time as the employee separates from service.

IRS Code Section 72 (u) **- Corporate-Owned Annuity**

When owned by non-natural persons (i.e. corporations, partnerships, trust, etc.) the annuity contract must comply with one of these exceptions:

A. is acquired by the estate of a decedent by reason of the death of the decedent,

B. is held under a plan described in section 401 (a) or 403 (a), under a program described in section 403 (b), or under an individual retirement plan,

C. is a qualified funding asset (as defined in section 130 (d), but without regard to whether there is a qualified assignment),

D. is purchased by an employer upon the termination of a plan described in section 401 (a) or 403 (a) and is held by the employer until all amounts under such contract are distributed to the employee for whom such contract was purchased or the employee's beneficiary, or

E. is an immediate annuity.

IRS Code Section 130(c) **– Qualified Assignment**

For purposes of this section, the term ''qualified assignment'' means 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 assignment assumes such liability from a person who is party to the suit or agreement or the workmen's compensation claim, and

(2) if:

(a) such 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 as such payments,

(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,

(d) 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

(e) such periodic payments are excludable from the gross income of the recipient under paragraph (1) or (2) of section 104(a).

The Taxpayer Relief Act of 1997 added workers' compensation payments under IRC § 104(a)(1) to the language of IRC § 130, making them eligible for qualified assignment.

IRS Code Section 130(d) **- Qualified Funding Asset**

For purposes of this section, the term "qualified funding asset" means 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 qualified assignment and not later than 60 days after the date of such assignment.

IRS Code Section 468B **- Special rules for designated settlement funds**

Establishes the use of Qualified Settlement Funds also know as 468(B) Trusts

***IRS Code Section 5891*-Structured Settlement Factoring Transactions**

Guides factoring transactions of structured settlements

***The Periodic Payment Settlement Act of 1982**

Clarified Section 104(a)(2) and 79-220, and created a new section, Section 130.

- the recipient can have no ownership rights in the annuity contract
- The Plaintiff cannot control the annuity, i.e., assign, accelerate, defer, increase, or decrease the payments.
- must be able to exclude the full amount of payments from gross income
- Any payments made to the estate after the recipient's death are generally fully excludable for income tax purposes to the extent that the pre-death payments were excludable

****Small Business Job Protection Act**

• Any damages flowing from tort claims that do not have a physical injury or physical sickness at their origin are taxable,

• Damages, other than punitive damages, that flow from tort claims having physical injury or sickness as their origin are excludable from gross income whether or not they are suffered by the injured party. (amended IRS section 104)

• Damages from wrongful death claims are also excludable from the recipient's gross income.

PRIVATE LETTER RULINGS (PLR)

IRS PLR 8831021

Code Section 104(a)(2) treatment of amounts received by a claimant pursuant to a qualified assignment does not appear to be jeopardized if:

• Defendant will be the sole owner of the annuity and will have all rights of ownership including, without limitation, the right to chance the Beneficiary.

***IRS* PLR 9017011**

Knowledge of the existence, cost and present value of an annuity contract used to fund a settlement offer does not cause these claimants to be in constructive receipt of the annuity contract or the amount invested in the annuity contract; therefore, periodic payments received pursuant to that settlement are excludable under I.R.C. § 104(a)(2).

IRS PLR 200836019

(1) The Taxpayer will not be in actual or constructive receipt of the Periodic Payments until the applicable cash payments are received.
(2) The taxpayer will include each of the Periodic Payments in their income in the year in which such payments are received.

IRS PLR 200809001

C has alleged that Entity's agent(s) X caused physical injury through Tort while he was a minor under the care of X. A substantial amount of time has elapsed since the alleged Tort occurred. C alleges that he continues to struggle with the trauma resulting from the alleged Tort. Because of the passage of time and because C was a minor when the Tort allegedly occurred, C may have difficulty establishing the extent of his physical injuries. Under these circumstances, it is reasonable for the Service to presume that the settlement compensated C for personal physical injuries, and that all damages for emotional distress were attributable to the physical injuries. Consequently, the Service should concede that compensatory damages paid to settle the claim are excludable from gross income for federal income tax purposes.

CASE LAW

Commissioner v. Schleier

Recovery under the ADEA is not excludable from gross income. A taxpayer must meet two independent requirements before a recovery may be excluded under 104(a)(2):
• The underlying cause of action giving rise to the recovery must be "based upon tort or tort-type rights", and

• The damages must have been received "on account of personal injuries or sickness."

New test for determining taxability: "First the taxpayer must demonstrate that the underlying cause of action giving rise to the recovery is 'based upon tort or tort-type rights', and, second, the taxpayer must show that the damages were received 'on account of personal injuries or sickness"'.

O'Gilvie v. United States
Petitioners' punitive damages were not received "on account of' personal injuries; hence the gross income-exclusion provision. Does not apply and the damages are taxable.

Childs v. Commissioner
Allowed for Plaintiff's attorneys to structure a portion of all of their associated legal fees when representing a client with a legitimate case under 104(a)(2).