Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B05
PLR-109799-23
Date:
November 01, 2023

TY:

Legend

Carrier =

Assignment Company =

Parent Company =

State X =
State Y =
Claimant =
Date A =
$a =
Fee =
x percent =
Date B =
Date C =

Dear :

This is in response to your request for two private letter rulings submitted on behalf of Carrier and Assignment Company by your authorized representative on Date B, as supplemented by a submission on Date C. The ruling requests involve the federal income tax treatment of an indexed annuity contract (the "Contract") that will be issued in connection with a structured settlement transaction involving Carrier and Assignment Company (the "Proposed Transaction"). Specifically, you have requesting rulings that (1) the periodic payments that will be made under the Contract are "fixed and determinable as to amount and time of payment" within the meaning of § 130(c)(2)(A) of the Internal Revenue Code (“Code”), even though the dollar amount of the payments may increase (but never decrease) from an initially-determined amount based on an objective formula that references a well-known market index, and (2) the Contract will not fail to be a "qualified funding asset" within the meaning of § 130(d) solely by reason of the potential increase in the periodic payments as described herein.

FACTS

Carrier is a stock life insurance company organized and operated under the laws of the State X. Carrier is licensed to engage in the life insurance business in the state in which Claimant resides. Carrier qualifies as a life insurance company under § 816(a) of the Code.

Assignment Company is a corporation domiciled in State X. Assignment Company conducts a business of assuming liabilities from third-party defendants to make periodic payments to third-party claimants pursuant to structured settlement agreements between such parties involving claims for personal injury or sickness.

Carrier and Assignment Company are subsidiaries of Parent Company, which is a holding company organized and operated under the laws of State X. Parent Company files a consolidated federal income tax return with various subsidiaries, including Assignment Company and Carrier.

Assignment Company assumes liabilities from third-party defendants to make periodic payments to third-party claimants pursuant to structured settlement agreements between such parties. In connection with that business, Assignment Company purchases annuity contracts from Carrier as "qualified funding assets" to support Assignment Company's obligations to make periodic payments to third-party claimants. Carrier, Assignment Company and Parent Company are hereinafter referred to as “the Companies.”

As explained below, before a Contract is issued the Claimant must select the duration of the Index Term, the duration of the Deferral Period, and the duration of the Payout Period, all of which also will be reflected in the terms of the Settlement Agreement so that it will align with the terms of the Contract as issued. The Claimant is a resident of State Y. Claimant was involved in an automobile accident when the defendant hit Claimant's vehicle. Claimant sustained severe injuries to her back and nerves. The defendant admitted liability, so summary judgment will be granted, and a trial is pending to address only the final amount of damages for Claimant's physical injuries.

Claimant anticipates applying approximately $a of her eventual damage award to the structured settlement as part of the proposed transaction in this ruling request. Claimant anticipates selecting a one-year Index Term (as explained below), a 5-year Deferral Period (as explained below), and a 25-year Payout Period (as explained below). Claimant has indicated that these selections will allow for the payout to commence near the start of her retirement age and, in the meantime, will give her access to positive returns of the S&P 500 Index while protecting her from downside market risk during the Deferral Period. Claimant has indicated that these selections will meet her needs.

Accordingly, Claimant and the defendant will enter into a structured settlement agreement ("Settlement Agreement"). The Settlement Agreement will obligate the defendant to make periodic payments to Claimant. The periodic payments will be excludable from Claimant's gross income pursuant to § 104(a)(1) or (2) of the Code. The Settlement Agreement will provide that the periodic payments must be determined as described in the Contract, discussed below.

Pursuant to the Settlement Agreement, the defendant will assign its payment liabilities thereunder to Assignment Company and will pay Assignment Company a lump sum for accepting the assignment. Assignment Company will deduct Fee from the lump sum and retain that fee as compensation for providing services in the transaction. Assignment Company will use 100% of the remaining portion of the lump sum (hereinafter, the "Net Single Premium") to purchase a single premium indexed structured settlement annuity certificate that is issued under a group annuity contract[1] ("the Contract") from Carrier as a qualified funding asset.

The group annuity contract will set forth the general terms under which Assignment Company can purchase annuities from Carrier with respect to different claimants in the course of Assignment Company's structured settlement business. For each such annuity that Assignment Company purchases under the group contract, Carrier will issue a "certificate" to Assignment Company that sets forth the details relating to that annuity and that particular claimant. The Contract that is the subject of this request for

[1] Group annuity contracts often are used in circumstances where an entity plans to purchase multiple annuities with respect to different annuitants. The group contract is issued to the entity and sets forth the general terms under which the entity can purchase such annuities. For each annuity that the entity purchases under the group contract with respect to a different annuitant, the annuity provider issues a certificate that sets for the specific terms that apply to that annuity, such as the name, age, and gender of the annuitant, the duration of the payments, the dollar amount of the payments and when they will be paid, the details of any amounts that may be payable upon the annuitant's death, and other rights and obligations of the parties. Using a group annuity and certificates in these circumstances, rather than the entity purchasing a separate individual annuity contract with respect to each annuitant, streamlines the process of purchasing multiple annuities over time and covering different annuitants, but does not otherwise affect the rights of any of the parties once a certificate is issued. Also, for federal income tax purposes each annuity certificate issued in this manner is treated as a separate annuity contract.

rulings will be such a certificate and will set forth the details of the payments to be made to support Assignment Company's payment obligations with respect to the Settlement Agreement involving Claimant. In other words, the "Contract" consists of the group annuity and the particular certificate thereunder relating to the Claimant.

The Contract will provide for periodic payments in fixed, scheduled dollar amounts that will commence on a specified future date, such as 10 years from the date the Contract is funded (the "First Payment Date"), with the possibility that the amount of those payments may increase (but not decrease) before the First Payment Date. The potential increase in the dollar amount of the payments will be based on an objective formula that reflects the positive performance (if any) of the S&P 500 Index during the period of time between the date the Contract is issued (the "Contract Date") and the end of the period for which payments are deferred (the "Deferral Period").

On the Contract Date, Carrier will specify the dollar amount of the "Minimum Guaranteed Annuity Payments" that are guaranteed to commence on the First Payment Date. Carrier will determine the dollar amount of the Minimum Guaranteed Annuity Payments by multiplying the Net Single Premium (described above) that Assignment Company paid for the Contract by a "Payout Rate" specified in the Contract. The Minimum Guaranteed Annuity Payments that will commence on the First Payment Date will never decrease, but they may increase as a result of positive index performance during the Deferral Period.

For this purpose, the Contract will provide an "Accumulation Amount" to which the Assignment Company will credit compound interest throughout the Deferral Period. The interest credits will be determined using a formula set forth in the Contract that reflects the positive performance (if any) of the S&P 500 Index, subject to a specified cap. If the index has a return of 0% or less for a specified period, no interest will be credited during that period and the Accumulation Amount will remain unchanged. Thus, during the Deferral Period, the Contract will provide the Claimant access to equity-based returns while shielding the Claimant from any potential negative market performance. This protected access to equity-based returns will give the Claimant a better chance of maximizing their periodic payments while still protecting the Claimant from market risk.

At the end of the Deferral Period, Carrier will use the Accumulation Amount to re-calculate the dollar amount of the periodic payments that will commence on the First Payment Date. This will be done by multiplying the Accumulation Amount as of the end of the Deferral Period (reflecting any interest credited during that period) by the Payout Rate specified in the Contract. The effect of this calculation is that the periodic payments will be higher than the originally-determined Minimum Guaranteed Annuity Payments to the extent that any interest was credited to the Accumulation Amount during the Deferral Period. In this sense, as each dollar amount of interest is credited to the Accumulation Amount, it "locks in" a future increase in the periodic payments that will commence on the First Payment Date.

The steps for determining the Accumulation Amount during the Deferral Period are set forth as follows. The initial Accumulation Amount will equal the Net Single Premium (described above) that Assignment Company paid for the Contract. Carrier guarantees that this initial Accumulation Amount will never decrease during the Deferral Period. Carrier will credit compound interest to the Accumulation Amount during the Deferral Period pursuant to a formula specified in the Contract. The formula will reference the change in value of the S&P 500 Index (excluding any dividends) over a series of specified "Index Terms." Index Terms are simply periods of time over which the return of the S&P 500 Index will be measured, and any interest credits will be determined based on those measurements.

As part of the Settlement Agreement the Claimant will choose an Index Term of one year, two years, five years, or some other period of years that Carrier permits. The Claimant's choice of the duration of the Index Term will be reflected in the Contract and will not change once the Contract is issued. For example, if the Claimant chooses a one-year Index Term, the performance of the S&P 500 Index will be measured every year under the Contract, whereas if the Claimant chooses a two-year Index Term, the performance will be measured every two years, and likewise for the other available Index Term durations.

At the end of each Index Term, Carrier will credit interest to the Accumulation Amount based on the positive performance, if any, of the S&P 500 Index during that Index Term, subject to an upward limit known as the "Cap Rate." The Cap Rate may change from Index Term to Index Term. Carrier will specify the Cap Rate at the beginning of each Index Term. If the rate of return on the S&P 500 Index at the end of an Index Term is 0% or less, no interest will be credited to the Accumulation Amount for that Index Term. If the rate of return on the index is positive but less than the Cap Rate, interest will be credited at the same rate of return as the index. If the rate of return on the index equals or exceeds the Cap Rate, interest will be credited at a rate equal to the Cap Rate.

For example, assume that the Index Term is one year and that Carrier specifies a Cap Rate of 8% for that Index Term. At the end of the Index Term: (i) If the S&P 500 Index incurred a 10% loss during the prior year, no interest will be credited and the Accumulation Amount will remain unchanged; (ii) If the index had a return of 4% during the prior year, which is a positive return but less than the Cap Rate, interest will be credited to the Accumulation Amount at a rate of 4% because that rate is less than the Cap Rate; or (iii) If the index had a return of 10% during the prior year, which is a positive return that is greater than the Cap Rate, interest will be credited to the Accumulation Amount at the Cap Rate of 8%. At the end of each Index Term, a new Index Term of the same duration will begin and the calculations described above will be made again at the end of that Index Term.[2]

[2] After the initial Index Term, each subsequent Index Term will be the same duration as the immediately preceding Index Term, except if that duration would extend past the Deferral Period, the final Index Term will be shortened to a one-year duration (or a series of one-year durations) that will coincide with the end of the Deferral Period.

Thus, in the example above involving an Index Term of one year, the calculations would be made annually. If the Index Term were two years, five years, or some other duration instead of one year, the same mechanics would apply, except that the determinations would be made every two years, five years, etc.

The rate of interest to be credited to the Accumulation Amount at the end of each Index Term will be multiplied by the Accumulation Amount that existed on the last day of the immediately preceding Index Term. In other words, the formula reflects a compound interest calculation; interest will be credited on all prior interest.

Following the Deferral Period is the “Payout Period,” which begins on the "First Payment Date." During the Payout Period, the Contract will provide for periodic payments in scheduled installments for the duration specified in the Contract and the Settlement Agreement. Depending on the payment duration that the Claimant ultimately selects in the Settlement Agreement, the duration could be the Claimant's entire life (a "life annuity"), the joint lives of the Claimant and a joint annuitant (a "joint life annuity"), a specified period of years (a "period certain"), or a life annuity or joint life annuity with a period certain.

The periodic payments that will commence on the First Payment Date will be paid in specified dollar amounts. The dollar amount of each periodic payment will at least equal the Minimum Guaranteed Annuity Payment amounts that were determined when the Contract was issued, as previously discussed. However, the dollar amount of each periodic payment may be adjusted upward to the extent that any interest was credited to the Accumulation Amount during the Deferral Period.

In that regard, the dollar amount of the periodic payments that will commence on the First Payment Date will be determined by multiplying the final Accumulation Amount as of the end of the Deferral Period by the Payout Rate specified in the Contract. The Payout Rate will be set on the Contract Date and will not change for the duration of the Contract. The Payout Rate will reflect commercially reasonable actuarial assumptions with respect to interest, expense, mortality, and the payout duration.[3]

As a result of this calculation, if the Accumulation Amount at the end of the Deferral Period exceeds the Net Single Premium that Assignment Company paid for the Contract, the dollar amount of the periodic payments will be higher than the Minimum Guaranteed Annuity Payments that Carrier originally determined when the Contract was issued. In this sense, each dollar of interest that is credited to the Accumulation

[3] The Payout Rate is calculated to produce an annual dollar amount of periodic payments. If the annuity payments will be made more frequently than annually, the annual payment amount determined using the Payout Rate will be divided by the number of payments to be made each year. Thus, if payments will be made monthly, the annual payment amount determined using the Payout Rate will be divided by 12.

Amount "locks in" an increase in the periodic payments that will commence on the First Payment Date. Once the dollar amount of the payments is determined at the end of the Deferral Period, the payment amounts will be permanently set and will not be subject to any further adjustment for index performance.

The Contract provides for certain payments if the Claimant dies before all the periodic payments under the Contract have been paid. If the Claimant dies during the Deferral Period, a specified percentage (currently x percent) of the Accumulation Amount will be paid to the Claimant's beneficiary(ies) in a lump sum. If the Claimant dies during the Payout Period, the remaining periodic payments, if any, will continue as scheduled and will be paid to the Claimant's beneficiary(ies). Alternatively, the Contract can be issued with a feature that, if elected at time of settlement, provides a lump sum payment in lieu of the remaining periodic payments. In such case, the lump sum will be equal to a specified percentage (currently x percent) of the cost of a new annuity contract that would provide the remaining scheduled periodic payments, computed using Carrier's annuity rates in effect on or about the date of the lump sum payment for new annuity contracts that are issued for the same or similar type of business as the Contract.

In support of its contractual liabilities under the Contract, Carrier expects to purchase, hold, and sell various fixed income assets (such as Treasury securities) and derivatives (such as options and swaps). Carrier generally intends to use the fixed income assets to support all its obligations under the Contract, and particularly its contractual liabilities involving the Minimum Guaranteed Annuity Payments under the Contract and the periodic payments that are locked in at the end of the Deferral Period. Carrier generally intends to use the derivatives it purchases to help support its contractual liabilities to credit interest to the Accumulation Amount during the Deferral Period based on the positive performance of the S&P 500 Index, subject to the Cap Rate. This investment approach of using primarily fixed income assets combined with some strategic hedging instruments is used almost universally by life insurance companies that issue annuity contracts and other products that provide returns based on a referenced market index while also guaranteeing the purchaser's principal.

This investment approach also dictates the Cap Rate that Carrier will declare at the beginning of each Index Term during the Deferral Period. Prior to each Index Term, Carrier will purchase certain types of derivatives that reference the S&P 500 Index to hedge Carrier's obligations to credit interest during that Index Term based on the positive performance of the index. The availability and cost of those derivatives at the time that Carrier purchases them will factor into the Cap Rate that Carrier declares for the Index Term. Very generally, the higher the cost of the derivatives that Carrier needs to purchase to hedge its liabilities, the lower the Cap Rate, and vice versa. However, the Cap Rate will never be lower than a guaranteed minimum rate required by state law.

Carrier will manage these investments in a way that attempts to at least equal the Accumulation Amount under the Contract and all similar contracts that Carrier has issued. Carrier's actual asset holdings, however, will not necessarily be the same as the assets comprising the S&P 500 Index that is used in the formula from which the Accumulation Amount derives.

Irrespective of the return that Carrier achieves through its actual investments, Carrier's obligations with respect to the Contract are based entirely on the objective formula set forth in the Contract. If Carrier's investments perform worse than the formula-based returns it has guaranteed under the Contract, Carrier bears the burden of the loss and must make it up by crediting additional amounts to the Contract from its surplus or other investments. If Carrier's investments perform better than the formula-based returns it has guaranteed under the Contract, Carrier will keep the excess. This is inherent in any insurance business.

Carrier is subject to stringent regulatory standards under the law of State X, its domiciliary state. Those insurance regulations are designed primarily to ensure that life insurance companies like Carrier remain solvent and able to satisfy their claims obligations, many of which are very long-term in nature. Pursuant to state regulation, Carrier is required to maintain assets sufficient to satisfy stringent capital and surplus requirements and to invest those assets in accordance with prescribed rules that further protect the company's claims-paying ability. Carrier's obligations under the Contract will be supported by its general asset account and overall claims-paying ability.

The Companies make the following representations with respect to §§ 130(c) and (d) in addition to the facts discussed above:

1. The Contract will be treated as an annuity contract under applicable state law.
2. Assignment Company will assume a liability to make periodic payments as damages on account of personal injury or sickness (in a case involving physical injury or physical sickness) from a person who is a party to the Settlement Agreement.
3. Claimant will be unable to accelerate, defer, increase, or decrease the periodic payments paid under the Contract or the Settlement Agreement.
4. Assignment Company's obligation to Claimant will be no greater than the defendant's obligation under the Settlement Agreement.
5. The periodic payments under the Settlement Agreement will be excludable from Claimant's gross income under § 104(a)(1) or (2) of the Code.
6. The Contract will be issued by Carrier to fund the periodic payments to Claimant pursuant to an assignment of a liability to make periodic payments as damages on account of personal injury or sickness (in a case involving physical injury or physical sickness).
7. The Settlement Agreement will provide that the dollar amount of each periodic payment must be determined as described in the Contract.
8. Assignment Company will designate the Contract as being taken into account under § 130 of the Code with respect to the assignment of liability.

9. Assignment Company will purchase the Contract from Carrier not more than 60 days before or after the date of the assignment of liability to make periodic payments.

REQUESTED RULINGS

The Companies request rulings that (1) the periodic payments that will be made under the Contract are "fixed and determinable as to amount and time of payment" within the meaning of § 130(c)(2)(A) of the Code, even though the dollar amount of the payments may increase (but never decrease) from the initially-determined Minimum Guaranteed Annuity Payments based on an objective formula that references a well-known market index; and (2) the Contract will not fail to be a "qualified funding asset" within the meaning of § 130(d) solely by reason of the potential increase in the periodic payments.

LAW AND ANALYSIS

Section 104(a)(2) of the 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) of the Code 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) of the Code 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) of the Code 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 periodic payments as determined in accordance with the methodology set forth in the Contract and surrounding facts depends on the performance of the S&P 500 Index, which is an objective basis for computing the amount of the periodic payments.

We therefore conclude that for purposes § 130(c)(2)(A), the periodic payments are “fixed and determinable” as to the amount and time of payment.

Accordingly, the Contract will not fail to be a "qualified funding asset" within the meaning of § 130(d) solely by reason of the potential increase in the periodic payments.

RULINGS

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

1. The periodic payments that Claimant will receive under the Contract 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 which the dollar amounts of the payments may increase (but never decrease) from an initially-determined amount based on an objective formula that references the S&P 500 Index. In addition, the other requirements of § 130(c) of the Code have also been met.
2. The Contract will not fail to be a "qualified funding asset" within the meaning of § 130(d) solely by reason of the potential increase in the periodic payments.

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 damages awarded to Claimant has been requested, and therefore no ruling is being issued, under § 104(a)(2) or any other provision of the Code to Claimant in this rulings letter. This ruling is directed only to the Companies 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 Companies 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 (the Companies). 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,

Kyle C. Griffin
Senior Counsel, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)

Cc: