DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF CHIEF COUNSEL

June 11, 2008

Number: **INFO 2008-0020**
Release Date: 6/27/2008

CC:ITA:4:
CONEX-120290-08

UIL: 104.03-00

The Honorable Jerry Costello
Member, U.S. House of Representatives
144 Lincoln Place Court, Suite 4
Belleville, IL 62221

Attention:

Dear Congressman Costello:

I am responding to your inquiry dated April 3, 2008, on behalf of your constituent, , who requests a change in federal tax law regarding the taxation of interest income earned on a United States Treasury bond ("Treasury bond") that she received in termination of a structured settlement periodic payment stream.

was physically injured in an automobile accident. In compensation for her injuries, she was receiving from a structured settlement company periodic payments of damages that were excludable from income under section 104(a)(2) of the Internal Revenue Code (Code). The structured settlement company subsequently dissipated the assets that were supposed to fund the periodic payments. In , settled a claim of misappropriation against the structured settlement company by agreeing to receive a Treasury bond in termination of the periodic payment stream.

Section 104(a)(2) of the Code generally excludes from income the amount of any damages received, whether as lump sums or as periodic payments, on account of personal physical injuries or physical sickness. Thus, excluded from income the periodic payments she was receiving from the structured settlement company. Similarly, she excluded from income the fair market value of the Treasury bond that she received as a lump sum in termination of the periodic payment stream.

When a taxpayer receives a lump sum payment of damages in satisfaction of a claim for personal physical injuries, the taxpayer excludes the lump sum from income under section 104(a)(2) of the Code, and must include interest paid on the lump sum in income under section 61(a)(4). Rev. Rul. 76-133, 1976-1 C.B. 34. Therefore, must include in income the interest payments she receives on her Treasury bond.

However, if acquired the Treasury bond at a premium, then she can elect to amortize the premium and reduce the amount of interest includible in income each year by the amount of premium amortizable in that year. Section 171 of the Code and the regulations thereunder provide rules for of bond premium. Bond premium generally is the amount by which the taxpayer's basis in a bond is greater than its stated principal amount. Generally, basis in the bond when she acquired it would be the bond's fair market value at that time. If basis in the Treasury bond when she acquired it exceeded its stated principal amount, then she would have acquired the Treasury bond at a premium in an amount equal to the excess. I have enclosed a copy of Publication 550, *Investment Income and Expenses*. Chapter 3 of Publication 550 provides additional information about bond premium amortization.

request to exempt from income taxation the interest on the Treasury bond she acquired to settle her damages claim and terminate the periodic payment stream of section 104(a)(2) damages would require legislative action by Congress.

I hope this information is helpful. If we can assist you further, please contact me at or at .

Sincerely,

George J. Blaine
Associate Chief Counsel
(Income Tax & Accounting)

Enclosure
Publication 550, *Investment Income and Expenses*