Department of the Treasury

Internal Revenue Service

Washington, DC 20224

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Person to Contact:

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November 10, 1998

LEGEND:

Assignee =

Claimant =

Issuer =

_x_ =

Dear :

This letter is in response to your ruling request regarding the application of § 130 of the Internal Revenue Code to the transaction described below. Your request involves the following two issues:

> Issue 1. Whether periodic payments of damages that are calculated pursuant to an objective formula based on the performance of the Standard & Poor’s 500 Stock Index and/or a mutual fund portfolio designed to achieve long-term growth of capital and moderate current income are "fixed and determinable as to amount and time of payment" under § 130(c)(2)(A); and

> Issue 2. Whether Claimant’s perfection of a security interest in the annuity used to fund the periodic payments through physical possession of the annuity will accelerate the time she is treated as receiving the periodic payments.

<u>FACTS</u>. Claimant is negotiating a settlement agreement with a defendant to recover damages, on account of a physical injury, that will provide for periodic payments over Claimant's life, or over the longer of Claimant's life or a _x_-year period. You represent that amounts payable under the settlement agreement will be excludable from Claimant’s gross income under

§ 104(a)(2).

The settlement agreement will require the defendant to make periodic payments both of a specified dollar amount (specified payments) and of a variable amount (variable payments) due on specific payment dates. The amounts of the variable payments will be calculated pursuant to an objective formula based on the performance of the Standard & Poor’s 500 Stock Index and/or a mutual fund portfolio designed to achieve long-term growth of capital and moderate current income. Under the objective formula the variable payments will increase if the net investment return of the portfolio is greater than the period equivalent of an assumed annual investment rate of percent and assumed annual equivalent expense charges of percent; will decrease if the net investment return is less than the period equivalent of percent; and will remain the same if the net investment return just equals the period equivalent of percent.

The schedule of the specified payments and the formula for determining the variable payments will be set forth in the settlement agreement which, once executed, may not be modified. The amounts of the periodic payments will never be less than the specified payments.

Claimant will authorize the assignment to Assignee of the defendant's liability under the settlement agreement. Upon receiving the assignment, Assignee will purchase an annuity from Issuer that is intended to be a § 130(d) qualified funding asset that provides both specified payments and variable payments reasonably related to the periodic payments under the settlement agreement.

Also, at Claimant's request, Assignee will provide Claimant with a security interest in the annuity. Under the assignment agreement, Claimant will receive a security interest in the annuity to the extent permitted to secure the promise of Assignee to make periodic payments. Assignee will continue to have all ownership and control rights in the annuity as long as it is solvent; however, the annuity will be placed in the possession of Claimant for the sole purpose of perfecting the security interest. The annuity will bear a stamp with the following wording:

NOTICE

> This annuity contract has been delivered to the possession of Claimant for the sole purpose of perfecting a lien and security interest of such person in this contract. Claimant is not the owner of, and

has no ownership rights in, this contract and may not anticipate, assign, pledge, encumber, or otherwise use this contract as any form of collateral. Please contact the issuer of this contract for further information.

You represent that Claimant's possession of the settlement annuity issued by Issuer will merely perfect a security interest in the contract pursuant to applicable state law.

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

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

Section 130(c) provides that a "qualified assignment" is the 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) that meets the requirements of § 130(c)(1) and (2).

Section 130(c)(2)(A) requires the periodic payments to be fixed and determinable as to amount and time of payment. Section 130(c)(2)(D) requires the periodic payments to be excludable from the gross income of the recipient under § 104(a)(2).

In addition, the last sentence of § 130(c) provides that the determination for purposes of Chapter 1 (relating to Normal Taxes and Surtaxes) of when the recipient of periodic payments is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of the assignment that grants the recipient rights as a creditor greater than those of a general creditor.

Section 130(d) provides that a qualified funding asset is 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, that meets certain requirements, including the requirement that 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. See Section 130(d)(2).

DISCUSSION: Issue 1. Section 130 was enacted into law by the Periodic Payment Settlement Act of 1982 ("Act"). The legislative history of the Act does not explain the reason for the inclusion of the "fixed and determinable" language in § 130(c)(2)(A). However it is clear that Congress in enacting § 130 believed that "a person who undertakes an assignment of the liability [to make periodic payments] from the person originally liable should not include amounts received for doing so in gross income if those amounts are used merely to purchase certain types of property to specifically cover the liability." H.R. Rep. No. 832, 97th Cong., 2d Sess. 4 (1982). In this case, Assignee is using the amounts it receives from the defendant (other than its fee) to purchase property that merely will be used to specifically cover its liability to Claimant.

In addition, in discussing the types of annuities that meet the definition of as qualified funding assets under § 130(d), the Conference Report for the Act states that, "It is intended that the definition of a 'qualified funding asset' ... encompass an annuity policy the payments from which end upon the death of the measuring life, i.e., an annuity with a life contingency." H.R. Conf. Rep. No. 984, 97th Cong., 2nd Sess. 12 (1982). Based on this legislative history, it is clear that periodic payments are not precluded from being fixed and determinable as to amount and time of payment under § 130(c)(2)(A) merely because the sum and number of payments and the precise date when the final payment will be made is unknown at the time of the assignment. The facts of this case in which the precise amount of a variable periodic payment is not known at the time of the assignment is not materially different.

Therefore, we believe that periodic payments that are determined with reference to an objective index are "fixed and determinable as to amount and time of payment." Specifically, we believe that the term "fixed" means that the assignee's obligation to make the periodic payments is fixed with finality by the terms of the settlement agreement and the term "determinable" means that there is an objective basis for calculating the amount and time of the periodic payments.

In this case, the amount and time of the periodic payments are fixed with finality by the terms of the settlement agreement. Further, the amounts of the payments are determinable because referencing them to increases and decreases in the Standard & Poor's 500 Stock Index and/or a mutual fund portfolio designed to achieve long-term growth of capital and moderate current income, provides an objective basis for calculating such amounts. Thus the assignment of the defendant's liability to Assignee will not fail to qualify as a qualified assignment under § 130(c) solely by reason of the variable payments Assignee will assume in the settlement agreement. Also, the annuity Assignee will acquire from Issuer will not fail to qualify as a qualified funding asset under § 130(d) solely by reason of the annuity's variable payments, which are reasonably related to the periodic payments under the qualified assignment.

Issue 2. Former § 130(c)(2)(C) required that the assignee not provide the recipient of the periodic payments with rights against the assignee greater than those of a general creditor. Section 6079(b)(1) of the Technical and Miscellaneous Revenue Act of 1988 repealed the requirement of former § 130(c)(2)(C) and added the last sentence of § 130(c) as set forth above. The Conference Report explains the amendment as follows:

> [A] liability assignment is treated as a qualified assignment notwithstanding that the recipient is provided creditor's rights against the assignee greater than those of a general creditor. The bill also provides that no amount is currently includible in the recipient's income solely because the recipient is provided creditor's rights that are greater than the rights of a general creditor. [Emphasis added.]

H.R. Conf. Rep. No. 1104, 100th Cong., 2d Sess. II-171 (1988).

Generally under § 451, receipt of a mere unsecured promise to pay is not taxable income upon receipt. However, a deferred payment obligation that is readily marketable and immediately convertible to cash is property the fair market value of which is income to a cash method taxpayer in the year of receipt. See Rev. Rul. 68-606, 1968-2 C.B. 42. See also Cowden v. Commissioner, 289 F.2d 20, 24 (5th Cir. 1961); Rev. Rul. 73-173, 1973-1 C.B. 40.

Under the facts of this case, the annuity contract is not readily marketable and not immediately convertible to cash because the language stamped on the front of the annuity contract prevents it from being pledged, assigned, or otherwise transferred. In addition, § 130(c) provides that the recipient of periodic payments will not be treated as having received payment solely because the recipient becomes a secured creditor. Therefore, provided the defendant's assignment to Assignee is a qualified assignment under § 130(c), Claimant's possession of the annuity contract merely to perfect a security interest in the contract as required by the applicable state law will not cause Claimant to receive income in the year Claimant takes possession of the annuity contract.

Accordingly, based strictly on the information submitted and representations made, we conclude that:

(1) The periodic payments of damages that Claimant will receive are fixed and determinable as to amount and time of payment under § 130(c)(2)(A) even though they are calculated pursuant to an objective formula based on the performance of the Standard & Poor's 500 Stock Index and/or a mutual fund portfolio designed to achieve long-term growth of capital and moderate current income;

(2) The annuity Assignee will acquire from Issuer will not fail to qualify as a qualified funding asset under § 130(d) solely by reason of the annuity's variable payments, which are reasonably related to the periodic payments under the qualified assignment; and

(3) Claimant's physical possession of the annuity solely to perfect, under applicable state law, a security interest in the annuity used to fund the periodic payments will not cause Claimant to receive income in the year Claimant takes possession of the annuity contract if the defendant's assignment to Assignee is a qualified assignment under § 130(c).

No opinions are expressed on the consequences of this transaction under any provision of the Internal Revenue Code, except as specifically set forth in the immediately preceding paragraph. Thus, for example, no opinions are expressed concerning whether the defendant's assignment of its liability to Assignee will be a qualified assignment under § 130(c), or whether the annuity will qualify as a qualified funding asset under § 130(d).

A copy of this letter ruling should be attached to any income tax return to which it is relevant. We enclose a copy for that purpose.

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

Sincerely,

Assistant Chief Counsel
(Income Tax & Accounting)

By ____________________________
Michael J. Montemurro
Senior Technician Reviewer
Branch 2

Enclosures:
copy of letter
copy for section 6110 purposes

cc: