

**Internal Revenue Service**

**Department of the Treasury**

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Person to Contact:

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Date: July 22, 1999

Legend:

SSC =

B =

C =

D =

L =

a =

b =

c =

Trust Address =

P.O. Box Z =

Dear :

This letter is in response to a ruling request on behalf of SSC, B, C, and D (collectively, the "Taxpayers") regarding the application of § 6041 of the Internal Revenue Code to checks paid to four individuals (E, F, G, and H) whom you know or suspect "sold" their rights to periodic payments of damages to factoring companies and checks paid to L, a garnishor that garnished certain periodic payments of damages.

**FACTS.** Many tortfeasors or their casualty insurance companies enter into structured settlement arrangements to finance the payment of damages arising out of physical injury that are excludable from a claimant's gross income under § 104(a)(2). Under a structured settlement agreement, a claimant agrees to receive damages in periodic

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payments over a number of years or the claimant's lifetime rather in a lump-sum. In some cases the direct obligor (for example, a tortfeasor or casualty insurer) will pay consideration to SSC in exchange for SSC's assumption of the liability to make periodic payments to the claimant. The amounts that SSC receives from the direct obligor are received pursuant to a qualified assignment described in § 130 and therefore are generally excludable from SSC's income.

SSC usually purchases an annuity contract issued by life insurance companies B or C to finance the periodic payment liability to a claimant that it assumed from a direct obligor. D is the common parent of an affiliated group of corporations (including SSC, B, and C) that files a consolidated income tax return.

SSC uses three different assignment forms in connection with its qualified assignments. All of the assignment forms provide that the periodic payments to which the claimant is entitled cannot be accelerated, deferred, increased, anticipated, sold or encumbered. In addition, all of the assignment forms provide that SSC may, in its discretion and solely for its convenience, have B or C send the payments due SSC under the annuity directly to a claimant. Generally SSC, as assignee, owns and controls the rights in the annuity and not the claimant. In each assignment, however, the claimant has the right to designate the address for the receipt of the payments.

SSC believes that five unnamed claimants (E, F, G, H, and K) entitled to receive periodic payments under the assignment agreements may have entered into factoring transactions. In a factoring transaction a claimant "sells" or "assigns" the claimant's rights to receive all or a portion of the periodic payments to an unrelated third party factoring company in exchange for a lump-sum payment.

SSC, B or C will suspect or have knowledge that a factoring transaction has occurred in the following three scenarios:

1. A claimant requests that his or her mailing address be changed to a post office box or a bank account, which occurred in Transaction 1, described below;
2. Multiple claimants request that their mailing addresses be changed to the same post office box, which occurred in Transactions 2, 3, and 4, described below; or
3. A court garnishment order is received that the periodic payments are to be sent to someone else, which occurred in Transaction 5, described below.

Taxpayers represent that in Transactions 1 through 5 SSC's assumption of the liability to make periodic payments was at the time SSC assumed it a qualified assignment within the meaning of § 130 and that the periodic payments made to E, F, G, H, and K were excludable from their incomes under § 104(a)(2). Taxpayers represent that in each of these five transactions they do not have sufficient knowledge of the factoring transactions to determine the portion (if any) of the payments that are income to the factoring company.

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In Transaction 1, E was injured in a vehicular accident in 1990. In 1992 E, the direct obligor, and SSC entered into a qualified assignment under which E would receive \$a per month for the longer of E's life or 20 years. In 1997 E requested that SSC mail future periodic payments to E care of Trust Address. Since that time the periodic payment checks naming E as payee have been mailed to Trust Address. E has not identified the reason for the address change.

In Transaction 2, F was injured in an automobile accident in 1990. In 1992 F, the direct obligor, and SSC entered into a qualified assignment under which F would receive periodic payments over a 17-year period. In 1998 F requested that SSC mail future periodic payments to F at P.O. Box Z. Since that time the periodic payment checks naming F as payee have been mailed to P.O. Box Z. F has not identified the reason for the address change.

In Transaction 3, G was injured in a vehicular accident in 1988. In 1990 G, the direct obligor, and SSC entered into a qualified assignment under which G would receive monthly payments for 10 years. In 1998 G requested that SSC mail future periodic payments to G at P.O. Box Z. Since that time the periodic payment checks naming G as payee have been mailed to P.O. Box Z. G has not identified the reason for the address change.

In Transaction 4, H was injured in a vehicular accident in 1991. In 1993 H, the direct obligor, and SSC entered into a qualified assignment under which H would receive \$b per month over a period of 10 years. In 1998 H requested that SSC mail future periodic payments to H at P.O. Box Z. Since that time the periodic payment checks naming H as payee have been mailed to P.O. Box Z. H has not identified the reason for the address change.

In Transaction 5, K was injured while under medical care at a hospital in 1984. In 1989 K, the direct obligor, and SSC entered into a qualified assignment under which K would receive annual payments of \$c for life. In 1998 SSC received notice of a court garnishment order to send the periodic payments to L. The order did not describe the reasons for the garnishment order. Thereafter, the periodic payment checks were addressed to L.

It is Taxpayers' position that the five assignment agreements, together with the terms of the structured settlement agreements, represent binding contractual agreements by the five claimants that the periodic damage payments are not assignable, making any factoring transactions invalid assignments under applicable contract law. Under this view, the periodic payments remain excludable from the claimants' income under § 104(a)(2) and, thus, are not subject to information reporting.

**LAW.** Section 6041(a) provides, in part, that all persons engaged in a trade or business and making payment in the course of that trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more

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in any taxable year shall render a true and accurate return to the Secretary setting forth the amount of those gains, profits and income and the name and address of the recipient of the payment.

Section 1.6041-1(c) of the Income Tax Regulations defines “fixed or determinable income.” Income is fixed when it is paid in amounts definitely predetermined, and is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

Rev. Rul. 80-22, 1980-1 C.B. 286, holds that crop insurance proceeds paid to farmers that had informed the payor insurance company that they were required to capitalize (and therefore include in basis) certain farming expenses was not fixed and determinable income under § 6041 because the payor could not require the farmers to disclose their bases in the destroyed crops, which information was required to determine the portion of the insurance proceeds constituting “gains, profits, and income” under that section. Thus, the payment of the insurance proceeds was not subject to reporting under § 6041.

**DISCUSSION.** The characterization of the periodic payments to payees following a factoring transaction requires scrutiny under applicable state contract law. If the factoring transactions are invalid under state law, then the periodic payments that SSC, B or C pay directly to E, F, G, H, and K after an invalid transaction are excludable from their income under § 104(a)(2). As used in § 6041, the term “gain, profits, and income” means an amount that is gross income to the payee. Thus, if the payments are excludable from claimants’ income under § 104(a)(2), the payments are not subject to reporting under § 6041.

If, however, the factoring transactions are valid under state law, then E, F, G, H, and K would not be the owners of the checks paid to them and would not include the amounts of such checks in their income, unless they convert the checks to their own use. In the facts you have presented, it does not appear that E, F, G, H, and K have converted the checks to their own use. Thus, under the facts presented, if the factoring transactions are enforceable, payment of the periodic payment checks to E at Trust Address and to F, G, and H at P.O. Box Z, would not be reportable to them under § 6041.

If a factoring transaction is valid under state law, then periodic payments paid to a factoring company would not be excludable from its income under § 104(a)(2). See People’s Finance & Thrift Co. v. Commissioner, 184 F.2d (5<sup>th</sup> Cir. 1950), aff’g per curiam 12 T.C. 1052 (1949) (taxpayer cannot exclude from income under the predecessor of § 104(a)(3) proceeds of accident and health insurance policies it acquired for value; the payments that the taxpayer received under the policies were a return on its investment). In this case, SSC, B, and C were not aware of any factoring company’s investment in a payment stream acquired from the five claimants. Thus, as in Rev. Rul. 80-22, SSC is without a method to determine the portion of the periodic payments that is gross income to the factoring company. Accordingly, the periodic payments in Transactions 1 through 5 are not subject to information reporting under § 6041 to the factoring companies

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involved in those transactions. In addition the garnishment order in Transaction 5 did not describe the reasons for the garnishment for payments made to L so that SSC is not aware if the payments are fixed and determinable payments of income to L. Thus payments made to L are not subject to reporting under § 6041.

**CONCLUSION.** Based strictly on the information submitted and representations made, we conclude that the periodic payments SSC makes in Transactions 1 through 5 to E, F, G, H or K and to L or other factoring companies involved in those transactions are not reportable under § 6041. However no opinion is expressed under § 6041 regarding payments made directly to E at other than Trust Address and to F, G, and H at other than P.O. Box Z if the factoring transactions are valid under applicable state law.

A copy of this letter should be attached to any income tax return to which it is relevant. Except as expressly provided in the preceding paragraph, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In addition, we express no opinion concerning the whether any of the factoring transactions discussed in this letter are valid or enforceable under applicable state laws.

We decline to rule on Taxpayers' request concerning whether factoring transactions adversely affect SSC's exclusion under § 130 of amounts it receives from direct obligors to assume their liabilities to make periodic payments to claimants. The Service may decline to issue a ruling when appropriate in the interest of sound tax administration or on other grounds whenever warranted by the facts and circumstances of a particular case. See section 7.01 of Rev. Proc. 99-1 1999-1 I.R.B. 6, 22.

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

Sincerely,

Deputy Assistant Chief Counsel  
(Income Tax & Accounting)

By \_\_\_\_\_  
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Senior Technician Reviewer, Branch 2

cc: