Periodic Payment Settlement Act

Public Law 97-473 (H.R. 5470); January 14, 1983 • As amended January 1, 1987

An Act to amend the Internal Revenue Code of 1954 with respect to the tax treatment of periodic payments for damages received on account of personal injury or sickness, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of American in Congress assembled.

SECTION I. AMENDMENT OF 1954 CODE

Whenever in title I or II an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

TITLE I-INCOME TAX PROVISIONS

Sec. 101. Treatment of recipient of settlement periodic payments.

(a) Treatment of Recipient.- Paragraph (2) of section 104 (a) (relating to compensation for injuries or sickness) is amended by striking out "whether by suit or agreement" and inserting in lieu thereof "whether by suit or agreement and whether as lump sums or as periodic payments."

(b) Treatment assignee–Payor.- (1) In General.-Part III of subchapter B of chapter 1 (relating to items specifically excluded from gross income) is amended by redesignating section 130 as section 131 and by inserting after section 129 the following new section:

"Sec. 130. Certain personal injury liability assignments."

"(a) In General.- Any amount received for agreeing to a qualified assignment shall not be included in gross income to the extent that such amount does not exceed the aggregate cost of any qualified funding assets.

"(b) Treatment of Qualified Funding Asset.- In the case of any qualified funding asset - "(1) the basis of such asset shall be reduced by the amount excluded from gross income under subsection (a) by reason of the purchase of such asset, and" (2) any gain recognized on a disposition of such asset shall be treated as ordinary income.

"(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) on account of personal injury or sickness (in a case involving physical injury or physical sickness)."

"(1) if the assignee assumes such liability from a person who is a party to the suit or agreement, and

"(2) if-

"(A) such periodic 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 of 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 section 104(a)(2).

"(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 assignments, 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."

(2) Conforming Amendment. The table of sections for part III of subchapter B of chapter 1 is amended by striking out the item relating to section 130 and inserting in lieu thereof the following new items:

"Sec. 130. Certain personal injury liability assignments."
"Sec. 131. Cross references to other Acts."

(c) Effective Date.- The amendments made by this section shall apply to taxable years ending after December 31, 1982.

Revenue Ruling 79-220

ISSUE

Does the exclusion from gross income provided by section 104(a)(2) of the Internal Revenue Code of 1954 apply to the full amount of monthly payments received in settlement of a damage suit or only to the discounted present value of such payments?

FACTS

A, an individual, sued B for damages for personal injuries. B is insured by M, an insurance company. Before trial, A accepted M's offer to settle the suit for a lump sum payment of $8,000 and M's agreement to provide A with monthly payments of $250 for A's lifetime or 20 years, whichever is longer, the payment to be made to A's estate after A's death if A should die before the end of 20 years. A had no right to the discounted present value of the monthly income (the present value of which, at date of settlement, was less than the total monthly payments to be provided) or to control the investment of that amount.

To provide the monthly payments for A, M purchased a single premium annuity contract from O, another insurance company. M advised O to make payments directly to A. However, M is the owner of the annuity contract and has all rights of ownership including the right to change the beneficiary. A can rely only on the general credit of M for collection of monthly payments.

LAW AND ANALYSIS

Section 61(a) of the Code and the Income Tax regulation thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived.

Section 104(a)(2) of the Code provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical and dental expenses) for any prior taxable year, gross income does not include the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness.

Section 1.104-1(c) of the regulations provides, in part, that the term "damages received (whether by suit or agreement)" means amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

However, if a lump-sum damage payment is invested for the benefit of a claimant who has actual or constructive receipt or the economic benefit of the lump-sum payment, only the lump-sum payment is received as damages within the meaning of Section 104(a)(2) of the Code, and none of the income from the investment of such payment is excludable under Section 104. See Rev. Rul, 65-29, 1965-1C.B.59, relating to damages awarded a claimant for tortious injuries in a lump-sum payment of 416X dollars over which claimant had unfettered control. The 416X dollars represented the discounted value of 520X dollars, which was found to be the reasonable cost of care, medicine, and medical attention for the injured person over a 10-year period. Rev. Rul. 65-29 holds that only the lump-sum payment, 416X dollars, is received as damages within the meaning of Section 104 (a)(2). See also Rev. Rul. 76-133, 1976-1 C.B. 34, which reaches a similar conclusion with regard to a court approved settlement awarded a minor and transmitted by the clerk of the court, in the name of the minor, to a savings and loan association for deposit in certificates of deposit.

In the instant case, there is a continuing obligation by M to pay $250 per month to A for this agreed period. M's purchase of a single premium annuity contract from the other insurance company was merely an investment by M to provide a source of funds for M to satisfy its obligation to A. See Rev. Rul. 72-25, 1972-1 C.B. 127, which relates to a similar arrangement made by an employer to provide for payment of deferred compensation to an employee. In Rev. Rul. 72-25 as here, the arrangement was merely a matter of convenience to the obligor and did not give the recipient any right in the annuity itself.

HOLDINGS

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 A in settlement of the damage suit because A 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 A should die before the end of 20 years, the payments made A's estate under the settlement agreement are also excludable from income under Section 104.

Revenue Ruling 79-313

ISSUE

Are payments received by the taxpayer under the circumstances described below excludable from the gross income of the taxpayer under section 104(a)(2) of the Internal Revenue Code?

FACTS

In 1977, the taxpayer sustained severe and permanent personal injuries as the result of being struck by an automobile. Thereafter the taxpayer brought an action against X, the owner-operator of the automobile. X carried automobile liability insurance with M, an insurance company.

In 1979, M proposed a settlement of taxpayer's suit against X, which the taxpayer accepted. Pursuant to the settlement agreement, M agreed to make fifty consecutive annual payments to the taxpayer, the first payment to be made one year after the date of settlement. These payments are for "personal injury, pain and suffering, disability, and loss of bodily function." The amount of each annual payment will be increased by five percent over the amount of the preceding annual payment.

The settlement also provides that the taxpayer does not have the right to accelerate any payment or increase or decrease the amount of the annual payments specified.

Under the agreement, M is not required to set aside specific assets to secure any part of its obligation to the taxpayer. The taxpayer's rights against M are no greater than those of M's general creditors. M's obligations to the taxpayer result solely from the settlement out of court of the legal action that the taxpayer instituted against X who was insured by M.

LAW AND ANALYSIS

Section 104(a)(2) of the Code provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 for any prior taxable year, gross income does not include the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness.

Section 1.104-1(c) of the Income Tax Regulations provides that the term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation) through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

The annual payments to be received by the taxpayer are amounts received through a settlement agreement entered into in lieu of the prosecution of a legal suit based upon tort or tort rights within the meaning of section 1.104-1(c) of the regulations.

Rev. Rul. 65-29, 1965-1 C.B. 59, holds that, when the taxpayer actually received the present value of an award for personal injury in a lump sum and invested it, any interest earned on the amount invested was taxable. However, in the instant case, even though the settlement agreement provides for increasing payments to be made annually, the taxpayer has neither actual nor constructive receipt, nor the economic benefit of the present value of the damages.

HOLDING

All payments received by the taxpayer in this case, pursuant to the settlement agreement, are excludable from the gross income of the taxpayer under section 104 (a)(2) of the Code.