

New Tax Code Section 5891 Regulates Factoring

Following is the text of the new Internal Revenue Code section 5891, which was added in section 115 of the "Victims of Terrorism Tax Relief Act of 2001 (H.R. 2884)," passed by the House and the Senate on December 20, 2001. The date of enactment was January 23, 2002, when the president signed it into law. Some of the new section's provisions are keyed to the date of enactment. At least two-thirds of the states have enacted "applicable State statutes," as defined by this federal law.

SEC. 115. TREATMENT OF CERTAIN STRUCTURED SETTLEMENT PAYMENTS.

(a) IN GENERAL— Subtitle E is amended by adding at the end the following new chapter:

CHAPTER 55—STRUCTURED SETTLEMENT FACTORING TRANSACTIONS

Sec. 5891. Structured settlement factoring transactions.

SEC. 5891. STRUCTURED SETTLEMENT FACTORING TRANSACTIONS.

(a) IMPOSITION OF TAX—There is hereby imposed on any person who acquires directly or indirectly structured settlement payment rights in a structured settlement factoring transaction a tax equal to 40 percent of the factoring discount as determined under subsection (c)(4) with respect to such factoring transaction.

(b) EXCEPTION FOR CERTAIN APPROVED TRANSACTIONS—

(1) IN GENERAL—The tax under subsection (a) shall not apply in the case of a structured settlement factoring transaction in which the transfer of structured settlement payment rights is approved in advance in a qualified order.

(2) QUALIFIED ORDER—For purposes of this section, the term 'qualified order' means a final order, judgment, or decree which—

(A) finds that the transfer described in paragraph (1)—

(i) does not contravene any Federal or State statute or the order of any court or responsible administrative authority, and

(ii) is in the best interest of the payee, taking into account the welfare and support of the payee's dependents, and

(B) is issued—

(i) under the authority of an applicable State statute by an applicable State court, or

(ii) by the responsible administrative authority (if any) which has exclusive jurisdiction over the underlying action or proceeding which was resolved by means of the structured settlement.

(3) APPLICABLE STATE STATUTE—For purposes of this section, the term 'applicable State statute' means a statute providing for the entry of an order, judgment, or decree described in paragraph (2)(A) which is enacted by—

(A) the State in which the payee of the structured settlement is domiciled, or

(B) if there is no statute described in subparagraph (A), the State in which either the party to the structured settlement (including an assignee under a qualified assignment under section 130) or the person issuing the funding asset for the structured settlement is domiciled or has its principal place of business.

(4) APPLICABLE STATE COURT—For purposes of this section—

(A) IN GENERAL—The term 'applicable State court' means, with respect to any applicable State statute, a court of the State which enacted such statute.

(B) SPECIAL RULE—In the case of an applicable State statute described in paragraph (3) (B), such term also includes a court of the State in which the payee of the structured settlement is domiciled.

(5) QUALIFIED ORDER DISPOSITIVE—A qualified order shall be treated as dispositive for

purposes of the exception under this subsection.

(c) DEFINITIONS—For purposes of this section—

(1) STRUCTURED SETTLEMENT—The term 'structured settlement' means an arrangement—

(A) which is established by—

(i) suit or agreement for the periodic payment of damages excludable from the gross income of the recipient under section 104(a)(2), or

(ii) agreement for the periodic payment of compensation under any workers' compensation law excludable from the gross income of the recipient under section 104(a)(1), and

(B) under which the periodic payments are—

(i) of the character described in subparagraphs (A) and (B) of section 130 (c)(2), and

(ii) payable by a person who is a party to the suit or agreement or to the workers' compensation claim or by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with section 130.

(2) STRUCTURED SETTLEMENT PAYMENT RIGHTS—The term 'structured settlement payment rights' means rights to receive payments under a structured settlement.

(3) STRUCTURED SETTLEMENT FACTORING TRANSACTION—

(A) IN GENERAL—The term 'structured settlement factoring transaction' means a transfer of structured settlement payment rights (including portions of structured settlement payments) made for consideration by means of sale, assignment, pledge, or other form of encumbrance or alienation for consideration.

(B) EXCEPTION—Such term shall not include—

(i) the creation or perfection of a security interest in structured settlement payment rights under a blanket security agreement entered into with an insured depository institution in the absence of any action to redirect the structured settlement payments to such institution (or agent or successor thereof) or otherwise to enforce such blanket security interest as against the structured settlement payment rights, or

(ii) a subsequent transfer of structured settlement factoring transaction.

(4) FACTORING DISCOUNT—The term 'factoring discount' means an amount equal to the excess of—

(A) the aggregate undiscounted amount of structured settlement payments being acquired in the structured settlement factoring transaction, over

(B) the total amount actually paid by the acquirer to the person from whom such structured settlement payments are acquired.

(5) RESPONSIBLE ADMINISTRATIVE AUTHORITY—The term 'responsible administrative authority' means the administrative authority which had jurisdiction over the underlying action or proceeding which was resolved by means of the structured settlement.

(6) STATE—The term 'State' includes the Commonwealth of Puerto Rico and any possession of the United States.

(d) COORDINATION WITH OTHER PROVISIONS—

(1) IN GENERAL—If the applicable require-

ments of sections 72, 104(a)(2), 130, and 461(h) were satisfied at the time the structured settlement involving structured settlement payment rights was entered into, the subsequent occurrence of a structured settlement factoring transaction shall not affect the application of the provisions of such sections to the parties to the structured settlement (including an assignee under a qualified assignment under section 130) in any taxable year.

(2) NO WITHHOLDING OF TAX—The provisions of section 3405 regarding withholding of tax shall not apply to the person making the payments in the event of a structured settlement factoring transaction.

(b) CLERICAL AMENDMENT—The table of chapters for subtitle E is amended by adding at the end the following new item:

'Chapter 55. Structured settlement factoring transactions.'

(c) EFFECTIVE DATES—

(1) IN GENERAL—The amendments made by this section (other than the provisions of section 5891(d) of the Internal Revenue Code of 1986, as added by this section) shall apply to structured settlement factoring transactions (as defined in section 5891(c) of such Code (as so added)) entered into on or after the 30th day following the date of the enactment of this Act.

(2) CLARIFICATION OF EXISTING LAW—Section 5891(d) of such Code (as so added) shall apply to structured settlement factoring transactions (as defined in section 5891(c) of such Code (as so added)) entered into before, on, or after such 30th day.

(3) TRANSITION RULE—In the case of a structured settlement factoring transaction entered into during the period beginning on the 30th day following the date of the enactment of this Act and ending on July 1, 2002, no tax shall be imposed under section 5891(a) of such Code if—

(A) the structured settlement payee is domiciled in a State (or possession of the United States) which has not enacted a statute providing that the structured settlement factoring transaction is ineffective unless the transaction has been approved by an order, judgment, or decree of a court (or where applicable, a responsible administrative authority) which finds that such transaction—

(i) does not contravene any Federal or State statute or the order of any court (or responsible administrative authority); and

(ii) is in the best interest of the structured settlement payee or is appropriate in light of a hardship faced by the payee; and

(B) the person acquiring the structured settlement payment rights discloses to the structured settlement payee in advance of the structured settlement factoring transaction the amounts and due dates of the payments to be transferred, the aggregate amount to be transferred, the consideration to be received by the structured settlement payee for the transferred payments, the discounted present value of the transferred payments (including the present value as determined in the manner described in section 7520 of such Code), and the expenses required under the terms of the structured settlement factoring transaction to be paid by the structured settlement payee or deducted from the proceeds of such transaction.

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