PRIVATE RULING 9017011; 1990 PRL LEXIS 221

PRIVATE RULING **9017011**

"This document may not be used or cited as precedent. Section 6110(j)(3) of the Internal Revenue Code."

SECTION 0104
Compensation for Injuries and Sickness
-- Damages

0104-0300

PRIVATE RULING **9017011;** 1990 PRL LEXIS 221

DATE: January 24, 1990

REFER REPL TO:

CC:IT&A:05-TR-31-3418-89

Dear * * *

This is in reply to your letter of September 12, 1989, requesting a ruling on behalf of Individual A and her children under section 104(a)(2) of the Internal Revenue Code.

You have represented that Individual A was married to the deceased, Individual B, and their children are Individuals C, D, and E. On date q, Individual B was struck by a tractor-trailer rig driven by Individual H, which crossed the center line of the highway and crushed Individual B's vehicle. Individual H was employed by Corp X, whose insurer is Corp Y. Under State J law, Corp X is liable for the acts of its employees, and Individuals A, C, D, and E have a cause of action for wrongful death against Individual H and Corp X. On behalf of Individual H and Corp X, Corp Y, as covering insurance company, has made a structured settlement offer to settle the wrongful death claim.

The proposed settlement includes: 1) $ b to the estate of Individual B for funeral expenses, 2) monthly payment of $ c (with annual increases of 4 percent) to Individual A for her life, 3) a payment of $ d to the estate of Individual B during 1989, 4) payments to Individual A of $ e in 1994, $ f in 1999, and $ d in 2004, and 5) annual payments to the children, Individuals C, D, and E, of $ g in each year in which a child is age 18, 19, 20, or 21 and an additional payment of $ d to the children during the year in which a child is age 25.

Corp Y will purchase a single premium deferred annuity contract to fund its obligations under the settlement offer. Corp Y will be the sole owner of the annuity contract and will have all rights of ownership, including the right to change the beneficiary. The family of Individual B will have no right to receive the present discounted value of monthly payments, to control the investment of the annuity value, or to accelerate, increase, or decrease the payments. The family of Individual B will rely only on the general credit of Corp Y for payment, and Corp Y will not be required to set aside assets or secure its obligations in any manner.

The settlement offer cannot be accepted by the family of Individual B until it is approved by the appropriate State J court because the children, Individuals C, D, and E, are minors. To assist both the court and Individual B's family in evaluating the settlement offer, Individual B's family and its representatives wish to learn the cost of the annuity contract to Corp Y.

Individual A has requested that the Service rule that:

1. The knowledge of the existence, cost, and present value of the annuity contract used to fund the settlement offer by Individual B's family and its representatives will not cause the family to be in constructive receipt of the annuity contract or the amount invested in the annuity contract.

2. The periodic payment received by Individual B's family pursuant to the settlement offer will be excluded from their taxable incomes.

Section 61(a) of the Code states, as a general definition, that, except as otherwise provided in this subtitle, gross income means all income from whatever source derived.

Section 1.451-2(a) of the Income Tax Regulations provides, in part, that as a general rule, income although not actually reduced to a taxpayer's possession is constructively received by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income ◆ is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

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, etc. expenses) for any prior taxable year, gross income does not include the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness. The Revenue Reconciliation Act of 1989 amended section 104(a)(2) to provide that the exclusion from gross income does not apply to punitive damages in connection with a case not resulting in physical injury or physical sickness. This amendment applies to any amount received after July 10, 1989, in taxable years ending after that date, unless the amount is received under a written binding agreement, court decree, or mediation award in effect on July 10, 1989, or pursuant to any suit that was filed on or before that date.

Under section 1.451-2(a) of the regulations, constructive receipt is determined by examining whether an amount is made available to a taxpayer without substantial restrictions. For this purpose, knowledge of the amount involved is not determinative. See, for example, Rev. Rul. 74-37, 1974-1 C.B. 112. Furthermore, on these facts, Individuals A, C, D, and E will have no interest in the assets of Corp Y, including the annuity contract, and may rely only on the general credit of Corp Y for collection of the periodic payments. No assets will be set aside for Individuals A, C, D, and E or otherwise made subject to their dominion and control. The purchase of an annuity will only be an investment by Corp Y to provide a source of funds with which it can satisfy its obligation to make the periodic payments. See Rev. Rul. 79-220, 1979-2 C.B. 74, and Rev. Rul. 72-25, 1972-1 C.B. 127.

In a supplemental statement, Individuals A, C, D, and E represent that no allegation has been made that they are entitled to punitive damages, or that the conduct of Individual H or Corp X constituted gross misconduct or wilful negligence. The settlement offer, therefore, is represented to be comprised entirely of compensatory damages with no punitive damages.

Accordingly, based on the factual representations and the above authorities, we rule that:

1. The knowledge of the existence, cost, and present value of the annuity contract used to fund the settlement offer by Individual B's family and its representatives will not cause the family to be in constructive receipt of the amount payable under the annuity contract or the amount invested in the annuity contract.

2. The periodic payments to be received by Individual B's family pursuant to the settlement offer will be excluded from their gross incomes under section 104(a)(2) of the Code.

No opinion is expressed as to the tax treatment of the transaction under the provisions of any other sections of the Code or regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction which are not specifically covered by the above rulings. In particular, no opinion is expressed as to whether the settlement offer consists solely of compensatory damages.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.
Sincerely yours,
Assistant Chief Counsel
(Income Tax & Accounting)
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Assistant to the Chief, Branch 5
Taxpayer Information: