FINAL PERSONAL INJURY REGS OMIT TORT TEST, QSF GUIDANCE

The Treasury Department on January 20 released final regulations on the exclusion of damages for physical injuries or sickness under section 104(a)(2), declining suggestions to require that excluded damage amounts be based on tort or tort-type rights and to address benefits received from qualified settlement funds (QSFs).

The government chose not to reinstate the requirement that damages be based on tort or tort-type rights, despite a comment that removing the language that appeared in previous regs would create confusion about what constitutes a personal injury. In response, the IRS said that legislative and judicial developments have eliminated the need to base the exclusion on tort concepts. (For T.D. 9573, see *Doc 2012-1180* or *2012 TNT 14-17*. For prior coverage, see *Tax Notes*, Mar. 1, 2010, p. 1039, *Doc 2010-3949*, or *2010 TNT 36-4*.)

''These regulations, like the proposed ones, are helpful in eliminating the tort or tort-type rights test,'' said Robert W. Wood of Wood LLP. According to Wood, the tort requirement caused some courts to overlook whether the payment was made on account of physical injuries or sickness, which he believes is the most important factor. He said he found it unfortunate that the regs did not elaborate on what constitutes physical injuries or sickness.

Commentators suggested that the government clarify the treatment of QSFs as part of the guidance project. However, the government said that doing so was beyond the scope of the proposed regulations.

Under section 468B, a QSF allows the party paying a judgment to receive a current deduction and lets the amounts distributed remain tax exempt for the claimant. QSFs were originally created to deal with mass-tort cases in which the timing of future payments was unknown. The funds allow a claimant to purchase financial products from providers that are separate from the insurance company involved in the settlement.

According to Jack L. Meligan, president of Settlement Professionals Inc., some practitioners have said that amounts paid to a QSF for an individual claimant should be taxed to the beneficiary, based on constructive receipt and economic benefit theories. ''Tax attorneys have been unable to agree whether a single claimant can be the beneficiary of a QSF,'' he said.

Meligan took the government's decision not to address the issue as a sign that it is not concerned about the use of QSFs for individual claimants. ''They've decided not to act, so in my opinion the risks are low,'' Meligan said. ■

— Matthew Dalton