Single-Claimant Qualified (468B) Settlement Funds?

By Robert W. Wood

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Section 468B of the Internal Revenue Code provides a kind of tax-free way station. Variously called a section 468B trust or a qualified settlement fund (QSF), it is a trust in which monies resolving litigation can repose after the defendants pay a settlement, but before the plaintiffs receive it. Added to the code in 1986, this provision has other ends, but its primary impetus was to secure income tax deductions for defendants. Defendants can claim their tax deduction when they pay a QSF, even though the plaintiff may not receive the money for months or even years.

Although ''economic performance'' normally keys defendant tax deductions to plaintiff income, section 468B offers accelerated deductions. Like QSFs, designated settlement funds (DSFs) are enabled by section 468B, and in most respects are similar. Although nomenclature varies, the QSF is the most prevalent label applied to these structures by lawyers and insurance professionals.

Classically, QSFs were used in large class actions, in which sorting out who is entitled to what, and locating potential class members, can take time. Gradually, however, such vehicles have come to be used in more garden-variety litigation. Today, QSFs are variously used to buy time to iron out final allocations among plaintiffs, determine final attorney costs, and facilitate time for plaintiffs to consider structured settlement alternatives. While QSFs are often used in cases involving many plaintiffs, they are also used when there are just a few plaintiffs, or even one.

For some years now, a question provoking a strong reaction from many people involved in the structured settlement industry is whether one can legitimately have a single-claimant QSF. If you consider the language of section 468B, and of section 1.468B-1(c)(2) of the Treasury regulations, you might conclude the question is straightforward, and that the answer must be yes. In particular, section 468B(d)(2)(A) allows DSFs (and by extension, QSFs) to be established to completely extinguish a taxpayer's tort liability with respect to claims described under subparagraph (D).

Those subparagraph (D) *claims,* in the plural, include ''present and future claims against the taxpayer (or any related person or formally related person) arising out of personal injury, death, or property damage.''[1] Nevertheless, reg. section 1.468B-1(c)(2) suggests the possibility of a single claim, and seems to distinguish QSFs from DSFs. It states that a QSF should be ''established to resolve or satisfy *one or more contested or uncontested claims* that have resulted or may result from an event (or related series of events) that has occurred and that has given rise to *at least one claim* asserting liability.''[2] The phrase ''one or more'' would seem to mean, well, one or more!

Nevertheless, whether a single-claimant QSF can qualify as a QSF (a seemingly tautological question) has generated considerable concern. Despite the lack of actual conflict on this point among the tax authorities (I have found no case, ruling, or even private letter ruling on this point), the controversy simmers and occasionally comes to a boil. The concern arguably stems (at least in part) from a series of interrelated tax questions that arise with a single-claimant QSF.

The doctrines of constructive receipt and economic benefit could perhaps apply to attribute income to a single claimant when a transferor transfers assets to a QSF. After all, one of the theories for allowing a QSF to operate as a tax-free way station between defendant and plaintiff is the uncertainty of multiple claimants, and the need to sort out who gets what and in what amounts. Given this broad theory, one could argue that a single-claimant fund is entirely different because timing would arguably be the only uncertainty.

Before we go on, however, there is additional nomenclature to consider. There can even be disagreement over what one means by single versus multiple claimants, a necessary benchmark for discussing this issue.

Defining Multiple Claimants

It is easy enough to say that uneasiness over the single-claimant controversy propels many practitioners to insist on having multiple claimants in any QSF. That has always been my approach. Yet it is not so easy to ascertain exactly what the phrase ''multiple claimants'' means.

The regulations do not address the number of claimants, and seem instead to focus on the claims. The

[1] Section 468B(d)(2)(D).
[2] Reg. section 1.468B-1(c)(2) (emphases added).

regulations talk of ''one or more contested or uncontested claims'' and an event (or related series of events) giving rise to ''at least one claim asserting liability.''[3] As such, the regulatory language focuses on the claim or claims, not on the claimant or claimants.

One claimant might have three claims. Multiple parties affected by an event or events (giving rise to at least one claim asserting liability) might constitute multiple claimants. One collective claim involving three claimants arguably would constitute multiple claimants. Moreover, suppose a woman brings a claim for personal injury against a defendant, and her husband brings a claim for loss of consortium. Do the woman and her husband constitute multiple claimants or a single claimant? They both have separate claims stemming from the same injury-causing event, so they should arguably be considered multiple claimants.

Nonetheless, one might argue that the couple has a unified interest (under state law or otherwise), which requires the couple to be considered only a single claimant for purposes of section 468B. After all, husband and wife are regarded for many purposes as a single taxpayer. If the injured woman's children also bring claims related to the woman's personal injury, do the children's claims represent separate claims, made by separate claimants? Even those who would argue that the woman and her husband should comprise a single claimant may see the children as multiple claimants.

Similar questions can arise regarding a law partnership that brings a claim for breach of contract. Does the firm have a single claim, or do the firm's partners have multiple claims related to the same breach of contract? More broadly, is a single claimant's attorney (who has a contingent fee claim) a separate claimant? One argument against that characterization is that only the plaintiff possesses the claim. The claimant's attorney merely helps to prosecute it in exchange for a percentage fee.

Nevertheless, one might argue that the claim is partly owned by the attorney, and that the attorney too is a claimant.[4] Even if one does not take that view, a lawyer's claim for fees would seem to fit within the description of a ''claim'' in the regulations. The QSF must be ''established to resolve or satisfy one or more contested or uncontested claims that have resulted or may result from an event . . . that has occurred and that has given rise to at least one claim asserting liability.''[5] Thus, the attorney's fees are arguably a separate claim of liability that has arisen from the liability-causing event, regardless of to whom that liability flows. This means one plaintiff and that plaintiff's lawyer may constitute two claimants.

Moreover, if a settlement between the parties makes the defendant/transferor directly liable for the plaintiff's attorney fees, then the argument that the attorney possesses a separate claim seems to gain even more traction. Semantics may also matter. If you expect the attorney fees for the plaintiff to be paid from the QSF, then it seems natural to name the attorneys as claimants/beneficiaries of the QSF along with the injured plaintiff.

It is common to address attorney fees in settlement agreements, too. From a tax perspective, one may wish to do so as a way of trying to preserve arguments that a plaintiff does not have income on the attorney fees. After all, if the legal fees are income to the plaintiff, the plaintiff's corresponding deduction for attorney fees is often insufficient to make the plaintiff whole. The Supreme Court in *Banks*[6] established the general rule that attorney fees were income. Under *Banks*, attorney fees in some cases may not be income to the plaintiff (perhaps in statutory fee cases, cases involving injunctive relief, and partnerships between lawyer and client).

Drafting a settlement agreement to try to preserve such agreements may involve having the defendant/transferor directly liable to pay those attorney fees. That too may make the attorney's status as a putative claimant to the QSF stronger. For the most part, it seems possible to avoid the single-claimant problem by documenting the case in a way that illustrates the multiple claims arising from the events, and the multiple claimants who are pursuing them.

Even such elementary steps as drafting a complaint with alternative claims instead of just pleading a single claim may be helpful. Most plaintiffs and their counsel hardly need prodding from tax advisers to do this. Likewise, because of the looming single-claimant QSF issue, it seems advisable to consider whether family members, business entities, or other parties (related or unrelated to the directly affected party) have claims that could be separately asserted against the defendant. Plaintiffs and their counsel already do this. Even if the claims giving rise to a QSF have not been disputed in formal litigation, it may be possible to name multiple claimants/beneficiaries to the QSF.

Control and Commissions

It is difficult to address the topic of single- versus multiple-claimant QSFs without noting the inevitable interactions between the technical side of the tax law on one hand, and the realities and vicissitudes of business on the other. It is entirely appropriate to address the technical question of what constitutes multiple claimants. It is also appropriate to address the tax doctrines surrounding this issue that could cause tax concerns, to which I'll turn in a moment.

Before embarking on an attempt to describe the single-claimant issue from a technical tax viewpoint, however, it may be useful demystification to address the political and business underpinnings of the single-claimant controversy. In fact, it would be a disservice to readers not to admit that the gasoline fueling the blaze on this issue is not a technical issue. Rather, it is a nitty-gritty business one.

Structured settlements involve the issuance of annuity products. The issuance of annuity products triggers the payment of commissions from the issuing life insurance companies to the originating agents. That means we must

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[3]Reg. section 1.468B-1(c)(2).

[4]*See* Robert Wood, ''Attorney and Client as Partners,'' *Tax Notes*, Oct. 13, 2008, p. 167, *Doc 2008-19753*, or *2008 TNT 200-43*.

[5]Reg. section 1.468B-1(c)(2).

[6]543 U.S. 426 (2005).

address commissions. There is an understandable desire on the part of originating agents to get paid. The customary commission to a broker is 4 percent of the annuity amount, and it is paid by the life insurance company on the issuance of the policy.

Fortunately or not, much as attorneys find themselves divided into camps of plaintiff attorneys and defense attorneys, the brokers who make their living selling annuities to fund structured settlements for injured plaintiffs (and annuities for attorney fee structures) generally find themselves allied either in the plaintiff broker or defense broker camp. That is not a rigid label. I have witnessed self-professed ''defense brokers'' appearing on the plaintiff's side, and those who are clearly ''plaintiffs' brokers'' representing defendants.

As a result, I sometimes question how indelibly painted the leopard's spots are in this particular setting. Nonetheless, in large part, the brokerage community is driven by this meant-to-be-fundamental distinction. Much of the criticism of the single-claimant QSF, and the abuses to which some argue it is subject, is really hysteria over plaintiffs' brokers thwarting the structure efforts of defense brokers.

The defense brokers complain that unscrupulous plaintiff's brokers simply take the cash from every settlement, and drop it into a newly minted QSF. Thereafter, the dogma goes, the QSF buys a structure, and the plaintiffs' broker makes off with the entire commission. The defense broker, who has often spent considerable time and energy on the relationship with the defendant or the defense attorney — not to mention getting annuity quotes and ratings for the injured party — is left out in the cold.

From the viewpoint of the plaintiff's broker, the only reason that conduct occurs is that defense brokers have traditionally tried to lock up all the business. Plaintiffs' brokers claim that defendants and their defense broker allies try to foist their own choice of particular annuity carriers, and even particular structures, onto poor plaintiffs. The defense brokers do that, the plaintiff brokers continue, all the while excluding the plaintiff's broker from the process, and from the commission. Plaintiffs' brokers claim defense brokers are in the pocket of the defendant or the defense attorney. The plaintiff's broker expends time and energy on running projections and doing underwriting legwork for the plaintiff, only to receive no commission at all.

Regardless of whether single-claimant QSFs are ultimately blessed by the IRS, the business dynamic fueling the debate is an unfortunate situation. Besides, sharing of commissions between plaintiff and defense brokers should solve the bulk of the controversies over these issues. Fortunately, there are plenty of brokers on both plaintiff and defense broker rosters who firmly believe in the concept of sharing commissions.

Nevertheless, as in any brokerage activity, there are exceptions. Plus, there will be situations in which a plaintiff's broker or a defense broker ''does all the work'' and only receives half a commission. In those situations, commissions might be split unevenly because there is no fixed schedule about how those arrangements can be struck. Of course, even if the convention is that the commission should be shared equally, chance may play a role. Inevitably, some brokers some of the time will come out on the short end of a commission split. In the long run, however, there should hopefully be a form of rough parity.

Apart from seemingly internecine broker disputes, some believe that the life insurance companies that issue structured settlement annuities also have a stake in seeing the IRS take aim at single-claimant QSFs. Yet if life insurance annuities will be purchased in traditional structured settlements with or without a QSF, it is difficult to see why the life insurance industry would have a dog in this fight.

One possible concern of life insurance companies was voiced by the National Structured Settlements Trade Association (NSSTA) in opposition to single-claimant QSFs.[7] The gist of that argument is that single-claimant QSFs would discourage the use of structured settlements.[8] NSSTA argued that the standard in the structured settlement industry has been for plaintiffs and defendants to negotiate jointly a periodic payment arrangement, forcing the parties to focus on the damages the claimant has suffered, encouraging structured settlements to meet the claimant's future periodic payment needs.[9]

If a single claimant could use a QSF, NSSTA continued, it would discourage educated negotiation between single plaintiffs and defendants.[10] Instead, NSSTA foresaw a return to the days of cash-only negotiations for a lump sum, with fewer cases settling based on periodic payment arrangements.[11] Whether that remains NSSTA's official position in 2008 (four years after the comments were made) is unclear, although emotions on the single-claimant issue still run high.

In any case, some would argue that NSSTA's crystal ball is clouded or even wrong, and that structures would in any event be encouraged, not discouraged. Some argue that the single-claimant debate is about control, and that defendants, the insurance industry, brokers, and NSSTA do not wish to lose any measure of control over the structured settlement industry.[12] Some proponents of single-claimant funds want them to be explicitly blessed by the IRS.[13] Others want to reverse. To date, there has been no IRS clarification.[14]

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[7]Letter from Malcolm Deener of the NSSTA to Treasury and the IRS, *Doc 2004-10665, 2004 TNT 98-17*.

[8]*Id.*

[9]*Id.*

[10]*Id.*

[11]*Id.*

[12]Richard B. Risk Jr., ''A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant,'' *Virginia Tax Review*, vol. 23, issue 4, p. 642 (Spring 2004), *available at* http://www.risklawfirm.com/files/Formatted_Articles/23VaTaxRev63 9.doc.

[13]*See generally* Risk, *supra* note 12, at p. 639; Fred Goldberg, Kenneth Gideon, and Jody Brewster to Treasury (June 19, 2003), *Doc 2003-15800, 2003 TNT 128-24*.

[14]*See* Daniel W. Hindert, Joseph Jules Dehner, and Patrick J. Hindert, *Structured Settlements and Periodic Payment Judgments*,

(Footnote continued on next page.)

It seems unlikely (to me at least) that having funds reposed in a single-claimant QSF would make it measurably less likely that an annuity to fund a structured settlement would be purchased by the QSF. Plaintiff brokers and defense brokers alike will still want to sell annuity policies to earn commissions. Whichever type of broker is involved, the broker will surely want an annuity to be purchased.

Moreover, it seems conceivable that the presence of more QSFs (regardless of the paucity of the claimants within each QSF) could actually make it *more* likely that structures would be purchased. I have seen plaintiffs unable to make quick decisions as a settlement approaches who simply determine not to structure any portion of their recovery. A plaintiff might be inclined to structure some or all of his recovery if allowed the additional time a QSF might afford.

One could debate the potential risk that a few particularly aggressive plaintiffs and their counsel might use a QSF as a kind of incorporated pocketbook. With no express time limit on the existence of a QSF, perhaps someone could attempt to flout the constructive receipt and economic benefit rules, letting money simply sit in a QSF to earn interest and dividends, doling it out to the plaintiff as and when needed from the purse strings of a friendly trustee and a cooperative judge. I have never seen that occur, but it may be a potential risk in virtually any small QSF.

Yet, I am not sure the risk of that behavior is any greater with a single claimant than it is if there are a few claimants. In either case, there may be little controversy about who will get what. In either case, there may be a possibility that bad actors may attempt to use the QSF merely to artificially hold off income that would otherwise accrue. Whether or not single-claimant QSFs are ultimately blessed by the IRS, there would seem to be several potential answers to such a fact pattern.

One could argue that in an extreme case, the QSF qua pocketbook would no longer have a purpose to resolve claims and pay them out, and, at least at that point, should fail to be treated as a QSF. The analogue might be to a tax-exempt organization under section 501(c)(3) that no longer qualifies because of private inurement or other failings. How the disqualification of an abusive QSF would work, and when it would be effective (retroactively or prospectively), might be debated. Yet, the potential that an abuse could occur, which seems possible whether there are a handful of claimants or just one, should arguably not drive the debate.

Constructive Receipt of Income

Against this business background, the technical tax arguments about constructive receipt and economic benefit seem pretty dry. The prospect of a single-claimant QSF can raise concerns regarding the doctrine of constructive receipt, although that doctrine may not ultimately apply. To understand the doctrine, it is helpful to address its underpinnings.

Taxpayers may compute their taxable income under a variety of permissible accounting methods.[15] The two primary accounting methods are the cash receipts and disbursements method and the accrual method.[16] Under the cash method, a taxpayer's income includes cash, property, or services in the tax year the cash, property, or services are actually or constructively received.[17] Under the accrual method, the taxpayer's receipt of income occurs in the tax year in which all events occurred that fix the taxpayer's right to receive the income, and the amount of that income can be determined with reasonable accuracy.[18]

The doctrine of constructive receipt applies under both cash and accrual methods.[19] Under the constructive receipt doctrine, income credited to a taxpayer's account, set apart, or otherwise made available so that it can be drawn on at any time (or so the taxpayer could have drawn on that income by giving notice of intent to do so) is considered constructively received, even though it is not actually reduced to the taxpayer's possession.[20] Conversely, there is no income when the taxpayer's control of its receipt is subject to substantial limitations and restrictions.[21]

A transfer of assets to a QSF does not result in constructive receipt of those assets by a claimant.[22] Indeed, a QSF provides a kind of trump card to the constructive receipt doctrine. Funds placed in a QSF for claimants are not considered received until the claimant *physically* receives distributions.[23]

Economic Benefit Doctrine

The economic benefit doctrine is another tax overlay that is relevant to the single-claimant question. Unlike the constructive receipt doctrine (which by its very nature does not involve *actual* receipt of income), the economic benefit doctrine arises when the taxpayer *physically* receives property or the evidence of a future right to property.[24] The economic benefit doctrine can apply to attribute income to a taxpayer in a year when assets are unconditionally and irrevocably paid to a trust to be used

section 3.08B[7][c] (Law Journal Press 2006) (noting that "Treasury has reportedly indicated that formal guidance will not promptly be forthcoming in the single-claimant issue").

[15]Section 446(a).

[16]Section 446(c).

[17]Reg. section 1.446-1(c)(i); reg. section 1.451-1(a).

[18]Reg. section 1.446-1(c)(ii).

[19]*United States v. Hancock Bank (Estate of Martin),* 400 F.2d 975, 978 (5th Cir. 1968).

[20]Reg. section 1.451-2(a).

[21]*Id*.

[22]Wood, "Curing Constructive Receipt for Tax Purposes?" *Tax Notes*, Mar. 24, 2008, p. 1307, *Doc 2008-4073*, *2008 TNT 58-24* (noting that "the rules of constructive receipt seemed to be thrown out the window when using" a QSF); letter from Richard B. Risk Jr. to Treasury (May 26, 2004), *Doc 2008-3015, 2008 TNT 30-19* (alleging that "constructive receipt has not been raised as an issue and whether a single-claimant QSF can make a qualified assignment").

[23]*See* Wood, *supra* note 22.

[24]*Minor v. United States,* 772 F.2d 1472, 1474 (9th Cir. Wash. 1985).

for a taxpayer's sole benefit.[25] On the other hand, if the taxpayer's receipt of those funds is restricted or subject to contingencies,[26] the economic benefit doctrine will not apply.

The economic benefit doctrine is illustrated by *Sproull v. Commissioner*.[27] In that case, a corporation entered into an agreement in 1945, which funded a trust with $10,500 for its employee, Sproull. The trust was to pay Sproull equal sums of $5,250 in 1946 and $5,250 in 1947. Hence, Sproull reported $5,250 of income from the trust in 1946, and then again in 1947. The IRS disagreed, contending that $10,500 was taxable to Sproull in 1945.

The Tax Court agreed with the IRS. The trust was established for Sproull in 1945. Sproull was the sole beneficiary, and the assets were used for his benefit, even though not at his direction. Notably, Sproull's future receipt of the amounts placed in the trust was not subject to a future contingency or possibility of return to his employer. The $10,500 placed in trust conferred an economic benefit on Sproull in 1945, so Sproull was taxable on it in 1945.

If a transferor irrevocably transfers funds to a QSF for the benefit of a *single* claimant, some would argue the situation is too close to *Sproull*. The funds may be beyond the reach of the transferor's creditors, and the single claimant's right to receive those funds may not be subject to a material contingency or restriction, nor even to potential dilution by payments to other claimants. In that situation, one could argue that the economic benefit doctrine should attribute income to the single claimant the moment those funds are transferred to the QSF for his benefit.[28]

Otherwise, the argument goes, there is a risk QSFs will be overused (particularly outside the realm of personal physical injury suits) as a way to defer income when there is no claims procedure, no multiplicity of claimants, and no uncertainty about the income the claimant will receive.[29] In short, despite the customary qualified status of a QSF, some argue that a single-claimant QSF bears the taint of economic benefit.

Periodic Payments to Personal Injury Claimants

Another wrinkle affecting the single-claimant QSF is statutory, and requires a bit of explanation. Claimants may reject a lump sum settlement payment in favor of periodic payments. Common reasons for periodic payments include the desire to address the needs of claimants who are minors, incompetent, unsophisticated, severely injured, or have other motivations to receive their payments periodically.[30] Periodic payments can help the claimant avoid squandering a lump sum settlement, helping conserve the funds for future medical and living expenses over many years.

Section 104(a)(2) excludes from gross income damages (other than punitive damages) paid on account of personal physical injuries or physical sickness.[31] That exclusion applies regardless of whether the amounts are received in accordance with a lawsuit or settlement, and regardless of whether those amounts are received in a lump sum or in periodic payments.[32] Hence, if a claimant receives a lump sum payment on account of personal physical injuries or physical sickness, the lump sum will be excluded from the claimant's income. Future earnings on that lump sum, however, will be taxable to the claimant.[33]

Settling parties can establish a periodic payment schedule, often referred to as a structured settlement.[34] A structured settlement of section 104(a)(2) damages allows the claimant to exclude each periodic payment in full.[35] Generally, a defendant will be expected to make a lump sum payment, even though the claimant desires periodic payments. The defendant will make a lump sum payment to a third-party assignee who assumes the liability to make periodic payments to the claimant. That third-party assignee helps avoid future interactions between the claimant and the defendant, avoids risks of defendant insolvency, etc.

Against the background of periodic payment arrangements, the question is whether the transferor's payment to the third-party assignee (of amounts to be later distributed to the claimant) should constitute income to the assignee. In a case involving a single-claimant QSF, the suggestion has been made that it might.[36]

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[25]*Sproull v. Commissioner*, 16 T.C 244, 247-248 (1951); *see* Risk, *supra* note 12, at p. 639.

[26]*See Minor v. United States*, 772 F.2d 1472, 1475 (9th Cir. 1985) (citing section 83(a) for the idea that income would not include property transferred to a taxpayer, which was subject to a substantial risk of forfeiture); *Drysdale v. Commissioner*, 277 F.2d 413 (6th Cir. 1960) (economic benefit doctrine did not apply to a taxpayer who was restricted by the terms of an agreement from exercising any dominion over funds in the possession of a trustee).

[27]16 T.C. 244 (1951).

[28]*See* letter from Stuart Odell and Joseph Dowley to Treasury (Oct. 8, 2003), *Doc 2004-13010*, *2004 TNT 122-41*.

[29]*Id.*

[30]*See* Goldberg et al., *supra* note 13.

[31]Section 104(a)(2). For further discussion of section 104(a)(2), see Wood, "What's Excludable? Despite Amendment, IRC Sec. 104 Leaves Some Questions Unanswered," *California CPA* (July 2006), p. 31.

[32]Section 104(a)(2).

[33]*See* Goldberg et al., *supra* note 13.

[34]For a detailed discussion of structured settlements, see Wood, *Taxation of Damage Awards in Settlement Payments*, Chapter 7 (regarding structured settlements) (Tax Institute 3d ed. 2008).

[35]Periodic Payment Settlement Act of 1982 (P.L. 97-473). Several rulings confirm that a stream of payments under an annuity contract purchased to find a personal injury settlement or judgment will be entirely tax free to the plaintiff. Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.

[36]*See* Goldberg et al., *supra* note 13 (noting that in the situation when a QSF makes a qualified assignment under Rev. Proc. 93-34 in a settlement involving a single claimant, it has been suggested that "there can be no qualified assignment because the assignee has not assumed a liability from a person who is 'a party to the suit or agreement' as required by section 130(c)(1)." In particular, the argument in support of that suggestion, which is somewhat tortured, goes as follows: If the economic benefit doctrine applies so that a single claimant is considered to be the recipient of settlement proceeds on their

(Footnote continued on next page.)

Section 130 Qualified Assignments

Under section 130, if a defendant pays a third-party assignee for assuming its liability to make periodic payments to an injured plaintiff, the amount the assignee receives in that "qualified assignment" will not be gross income to the assignee, except to the extent the amount exceeds the aggregate cost of the "qualified funding asset."[37] Although the assignee may be taxed on the fee it charges to make periodic payments to the claimant, it will not be taxed on the amounts it receives from the defendant with which to make those periodic payments.

If section 130 did not exist, a lump sum payment to a third-party assignee for purposes of making later periodic payments to a claimant would be income to the third-party assignee in the year received.[38] The assignee could thereafter deduct periodic payments made to the claimant. Even so, receiving income in the first year followed by pro rata deductions over the ensuing 20 years would be quite unpalatable.[39] Section 130 avoids that bunching of income to the assignee by allowing the assignee to exclude the qualified assignment from its income, to the extent the payments do not exceed the assignee's cost of the qualified funding asset.[40]

The basic model of a qualified assignment is as follows: First, a defendant or its liability insurer gives the claimant a promise to pay money in the future. Then, the defendant or its liability insurer transfers that obligation to a substituted obligor/assignee, who thereafter is liable on the payment obligations. Section 130 imposes several technical requirements regarding what constitutes a qualified assignment and a qualified funding asset.

Among other requirements, a qualified assignment means the assignee must assume the liability from a person who is a party to the suit or agreement, or to the worker's compensation claim.[41] One question is whether the QSF is a party to the suit or agreement for purposes of making a qualified assignment and applying the section 130 gross income exclusion. In Rev. Proc. 93-34,[42] the IRS specified requirements under which a DSF or QSF will be treated as "a party to the suit or agreement" under section 130(c)(1) for purposes of determining whether a qualified assignment has occurred.

Rev. Proc. 93-34's requirements for when a DSF or QSF will be considered "a party to the suit or agreement" under section 130(c)(1) are as follows:

1. the claimant must agree in writing to the assignee's assumption of the DSF's or QSF's obligation to make periodic payments to the claimant;

2. the assignment must be made with respect to a claim on account of personal injury or sickness (in a case involving physical injury or physical sickness) that is a claim for which a DSF or QSF has been properly established;

3. each qualified funding asset purchased by the assignee in connection with the assignment by the DSF or QSF must relate to a liability to a single claimant to make periodic payments for damages;

4. the assignee may not be related to the transferor (or transferors) to the DSF or QSF within the meaning of sections 267(b) or 707(b)(1); and

5. the assignee must not be controlled by, nor may it control, directly or indirectly, the DSF or QSF. In that context, examples of control include situations when the assignee is a corporation whose stock is owned by the DSF or QSF, or when the assignee is a trust whose trustee is the DSF's or QSF's administrator.[43]

If those and the other requirements of section 130 are met, then the DSF's or QSF's assignment will be a section 130 qualified assignment. The transferor will not be deemed to have received a distribution from the DSF or QSF when a qualified assignment is affected.[44]

Unanswered Questions

Rev. Proc. 93-34 helps to clarify when a third-party assignee can exclude from its gross income monies in a qualified assignment received via a DSF or QSF.[45] It also clarifies the requirements to ensure that such a qualified assignment will not be deemed a distribution (and thus, income) to a transferor.[46] Some believe that Rev. Proc. 93-34 does not answer whether the economic benefit doctrine should apply to attribute income to a single claimant of a DSF or QSF when that DSF or QSF temporarily holds assets that will later be subject of a section 130 qualified assignment to a third-party assignee.[47]

The major concern seems to be that assets temporarily residing in a DSF or QSF could immediately be deemed income to a single claimant by virtue of the economic benefit doctrine. The foregoing concerns have led some practitioners to seek further guidance from the IRS (about whether the economic benefit doctrine will attribute income to a single claimant) when a DSF or QSF assigns periodic payment obligations to a third-party assignee.[48] To date, however, the IRS has provided no guidance.

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transfer to a settlement fund, then in that case, it would follow that the transferor of settlement fund would be the claimant, not the defendant. In that case, the settlement fund could arguably not be a QSF treated as a party to the suit or agreement under Rev. Proc. 93-34, and therefore, the assignment could not constitute a section 130 qualified assignment). In essence, the qualified assignment must occur for section 130's exclusion from the third party's income to be effective.

[37]Section 130(a).

[38]Goldberg et al., *supra* note 13.

[39]*Id.*

[40]*Id. See also* section 130(a); Wood, *Taxation of Damage Awards in Settlement Payments*, para. 7.5.

[41]Section 130(c)(1).

[42]1993-2 C.B. 470, *Doc 93-8638, 93 TNT 167-9*.

[43]Rev. Proc. 93-34, 1993-2 C.B. 470, section 4.

[44]*Id.*

[45]*Id.*

[46]*Id.*

[47]*See* Goldberg et al., *supra* note 13; *see also* Risk, *supra* note 12, at p. 639.

[48]*See* Goldberg et al., *supra* note 13; Odell and Dowley, *supra* note 28; Risk, *supra* note 12, at p. 639.

The larger question is whether a single-claimant DSF or QSF can avoid the economic benefit doctrine generally, in non-personal injury damage settings or otherwise. Despite the ''one or more'' statutory and regulatory language, one can argue that QSFs were originally meant to settle lawsuits involving mass torts with multiple claimants. They were not intended (so the argument goes) to allow a single claimant to defer income.[49] Some argue that the economic benefit doctrine ought to attribute income to a single claimant when the transferor transfers assets to a QSF for that single claimant's benefit.

On the other hand, there is a compelling argument that the plain language of the statute should control. If the statute says plainly that QSFs can be used to resolve or satisfy liabilities with a mere single claimant — as it seems to — that should be enough. Indeed, imposing the economic benefit doctrine on a single claimant would arguably subvert (if not outright defeat) the language of section 468B and at least one intended purposes of a QSF.

[49]*See* Risk, *supra* note 12 (which includes a reference to this sort of argument).

There are plenty of provisions in the Internal Revenue Code that contemplate amounts to be set aside for a particular person, and that do not contemplate current taxation. For example, the tax-qualified pension rules include such provisions. Moreover, various tax deferral provisions (such as section 1031) arguably do as well. That is so notwithstanding the economic benefit doctrine. Yet in those cases, no one argues that some overarching economic benefit ethos trumps everything else.

Conclusion

It seems unlikely that any amount of argument will alleviate the squabbles over whether single-claimant QSFs should or should not be permitted. Moreover, the debate seems to be far more about whose ox is being gored than it is about technical tax issues. Despite all this, anyone who is risk averse (as most tax lawyers surely are) should tread carefully.

After all, despite the ''one or more'' language of section 468B, there is some concern that the IRS may eventually nix single-claimant QSFs. If the IRS does so despite the statutory language, it will probably not do so retroactively. Nevertheless, as long as the single-claimant controversy remains unresolved, my personal answer is to establish a QSF with more than a single claimant.