

Non-Qualified Assignments and Structured Installment Sales



A non-qualified assignment is a transfer of payment obligations that does not qualify under IRC Section 130. Non-qualified assignments, however, do share certain similarities as well as certain differences with assignments that do qualify under IRC Section 130 (“*qualified assignments*”).

Qualified Assignments Compared

The term “*qualified assignment*” is defined for tax purposes by IRC Section 130. “*Qualified assignment*” means that the defendant or its liability insurer (1) first gives the claimant a promise to pay money in the future; (2) then transfers that obligation to a substituted obligor pursuant to IRC Section 130; and (3) thus extinguishes its contractual liability for the obligation so transferred.

IRC Section 130 places no restrictions on who may be an assignee, nor does it designate any regulatory authority for assignees.

IRC Section 130 provides that any amount received by an assignee for assuming a periodic payment obligation may be excluded from the assignee’s gross income if seven basic requirements are satisfied:

- (1) The underlying tort claim involves physical injury or physical sickness.
- (2) The periodic payments are excludable by the recipient under IRC Sections 104(a)(1) or (2).
- (3) The assignor is a party to the suit or agreement which gives rise to the obligation.
- (4) The periodic payments are fixed and determinable as to amount and time of payment.
- (5) The periodic payments cannot be accelerated, deferred, increased or decreased by the recipient of the payments.
- (6) The assignee’s periodic payment obligation is no greater than that of the assignor.
- (7) The assignee purchases qualified funding assets (an annuity or U.S. Government obligations) that are used to fund the periodic payment obligations.

Reasons for Using Non-Qualified Assignments

In general, there are two basic reasons for using a non-qualified assignment. First, non-qualified assignments offer the ability to settle a claim and/or to fund a periodic payment obligation when neither the claim nor the obligation are excludable by the recipient under IRC Section 104(a)(1) or (2).

Examples of these types of cases include subjects as diverse as discrimination, contract disputes, non-physical injuries, punitive damage awards, sexual harassment, civil rights violations, Americans with Disabilities Act claims, environmental litigation, legal malpractice, construction defects, divorce, property disputes, pre-August 5, 1997 Workers’ Compensation, installment sales and contingent attorney fees.

Second, non-qualified assignments offer the ability to fund a periodic payment obligation using a financial product other than a “*qualified funding asset*” – an annuity or U.S. Government obligation. Examples include certain types of “*market-based*” structured settlement products.

International Companies

There is nothing theoretically problematic with a qualified assignment. However, U.S. based non-qualified assignment companies generally will be subject to applicable tax on the amount received from the entity

assigns the periodic payment obligation to the non-qualified assignee when it receives funds to purchase assets to support its long-term obligations. The United States imposes additional tax on the owner of an annuity that is a “*non-natural person*” under IRC Section 72(u).

As a result, almost all non-qualified assignees are “*international companies*,” located “*off-shore*,” so they are not subject to U.S. taxation – generally as a result of a tax treaty between their country of domicile and the United States.

Nothing prevents an international company from accepting what would otherwise be a “*qualified assignment*” under IRC Section 130. However, under such circumstances the characterization of a “*qualified assignment*” would be irrelevant assuming the international company is not subject to United States tax laws.

Independent Life’s Non-Qualified Assignees

Independent Life currently utilizes three different assignment companies for our non-qualified cases depending on the type of case. For all of our iStructure indexed annuity cases, including structured installment sale cases, we have an exclusive relationship with Dominion Assignment Company (Switzerland) SPC Limited.

For non-qualified assignment cases utilizing our traditional fixed annuities, Independent Life has business relationships with Structured Assignments SCC, organized under the laws of Barbados, and Kenmare Assignment Company Limited, organized under the laws of Ireland.

Each of our three assignment companies is domiciled in a jurisdiction whose tax treaty with the United States provides that annuities are taxable only in the country where the owner of the annuity resides.

Claimant Benefits and Requirements

A non-qualified assignment, therefore, can be used by claimants (or plaintiff attorneys) who want to defer future payments from immediate income tax, but will be receiving amounts that themselves are taxable.

From the claimant’s tax perspective, a non-qualified assignment is structured and operates like a qualified assignment, except that the claimant cannot benefit from the provisions of Section 130 that allow qualified assignment claimants to be treated better than general creditors.

The financial benefits of a non-qualified assignment can be substantial. Although not binding precedent, PLR 10851-0 (June 2, 2008) confirms that, if properly devised, a non-qualified assignment will avoid immediate taxation on the gross amount paid to the assignee in the year a settlement is concluded, with periodic payments taxed instead in each year they are received by the settling claimant.

As long as the documents make clear that the claimant does not have the type of rights that would create constructive receipt or show immediate economic benefit, the amounts received will be taxable in the year actually received by the claimant.

Structured Installment Sales

Non-qualified assignments can also be utilized to defer capital gains taxation as well as ordinary income tax. Structure installment sales represent a good example and a growing market. Independent Life's iStructure indexed annuity is proving to be an ideal funding product for this market.

A structured installment sale can be utilized for the sale of real estate or businesses or any transaction for which a traditional installment sale is permitted under IRC §453. Prime candidates to utilize installment sales include sellers with some income flexibility at the time they are selling their business or property.

For eligible transactions and appropriate sellers, the advantages of an installment sale to the seller, compared with a cash only sale, can be substantial. Their potential benefits from an installment sale can include substantial tax savings resulting from deferred taxes at capital gains rates plus additional estate planning opportunities. The concurrent potential advantage for the installment sale buyer is to negotiate a lower purchase price.

Historically, installment sales have involved a potential risk for the seller, the possibility of the buyer's default. Although a typical installment sale might involve some form of security – a mortgage, a letter of credit, a security interest, or some other form of pledge agreement – none of these alternatives have proven satisfactory. What installment sellers want is security and tax deferral and not the burden and responsibility of reacquiring the same business or property they originally sold and loss of that tax deferral.

Several years ago, a new type of installment sale, the structured installment sale, was introduced into the marketplace. The concept originated in the structured settlement industry where life insurance companies have used assignments and guaranteed annuities since the early 1980s to provide tax-efficient solutions for recipients of personal injury cases.

Multiple life companies have offered annuity products with assignments which are applicable for installment sales. These products have combined the tax deferral benefits of traditional installment sales with the added economic strength and security of highly rated, state regulated life insurance companies.

iStructure Index Annuity

Independent Life Insurance Company (ILIC) is one such life insurance company – and we now offer a new product with added features and benefits for the structured installment sale market – the iStructure indexed annuity.

iStructure is the first uncapped indexed structured settlement annuity and its design is specifically applicable to installment sales. That means, in addition to security and tax deferral, with the iStructure indexed annuity, an installment seller can also obtain potential market-based payment growth over the installment payout period.

Offering security, tax deferral and market-based benefit growth – iStructure introduces a new era in installment sales using a non-qualified assignment that features Dominion Assignment Company (Switzerland) SPC Limited as our exclusive assignment company.

Conclusion

Properly agreed and documented, a non-qualified assignment is an effective means of funding an expanding range of cases and other financial obligations. New, innovative products such as Independent Life's iStructure index annuity are encouraging structured settlement and settlement planning professionals to identify and grow new markets including structured installment sales.

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