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To the races!—This painting, "Rachel Alexandra," by Shawn Faust, sold on June 6, 2010, at The Art Gallery at Devon to benefit the Bryn Mawr Hospital in Pennsylvania, p. 4.

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Death and Damages Can Be Taxing

Knowing the financial consequences can give your client a leg up when settling a case

You may have clients who are plaintiffs in a wrongful death or survival lawsuit (based on another's death) or in a lawsuit stemming from their own personal injuries. Those clients, and their personal injury attorneys, often don't realize the importance of settling cases with future income and estate tax liabilities in mind. But their understanding, or at least their appreciation of the potential tax liabilities' significance, is critical so they can take this into account when designing the settlement.

Depending on how a settlement is structured, plaintiffs in a wrongful death or survival lawsuit may be saddled with unexpected income and estate tax liability. Also, if a plaintiff in a personal injury lawsuit dies prematurely, the untimely death can cause large amounts of assets to enter his gross estate and become taxable, sometimes resulting in surprisingly considerable estate tax liability, even though the beneficiaries of the plaintiff's estate may only be entitled to future payments. To avoid surprises and reduce this tax liability, it's important for trusts and estates attorneys to be aware of clients' pending litigations and advise them of the income and estate tax implications of proceeds obtained from these potential settlements.[1] Forward-thinking planning may enable a plaintiff to access significant tax benefits by carefully designing his settlement.

Wrongful Death, Survival Law

States typically provide for personal injury causes of action by the decedent's beneficiaries, estates or both.

Wrongful death laws create causes of action after the death of an injured party for the benefit of certain beneficiaries. For example, New Jersey provides "for the exclusive benefit of the persons entitled to take any intestate personal property of the decedent, and in the proportions in which they are entitled to take the same ... "[2]

Deceptively complex, the phrase "on account of" has been frequently litigated.

Survival laws allow certain causes of action to become assets of a decedent's probate estate. For example, Connecticut provides that in any "action surviving to or brought by an executor or administrator for injuries resulting in death, whether instantaneous or otherwise, such executor or administrator may recover from the party legally at fault for such injuries … "[3]

The estate and income tax consequences of both types of lawsuits must be considered, especially during settlement negotiations.

Estate tax consequences. Proceeds from wrongful death and survival lawsuits aren't subject to estate tax. Such actions only spring to life at the time of a decedent's death, too late for the decedent to have an interest in them.

Since 1975, the Internal Revenue Service has taken the position that neither wrongful death nor survival law proceeds give rise to estate tax liability.[4] The estate tax consequences of proceeds awarded based on wrongful death and survival laws flow directly from the conclusion

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that neither wrongful death nor survival law proceeds become part of a decedent's gross estate.

Revenue rulings both before and after 1975 have held that because a wrongful death cause of action doesn't exist before an injured party's death, proceeds from the action don't enter the gross estate for estate tax purposes.[5] The IRS explained the rationale of this rule in 1954:

> The decedent in his lifetime never had an interest in the right of action or in the proceeds. He didn't create the right, it was created by statute and vested in the persons designated in the statute. Inasmuch as the decedent had no right of action or interest in the proceeds at the time of his death, nothing "passed" from the decedent to the beneficiaries. Accordingly, the amounts recovered by the beneficiaries wouldn't be includible in the decedent's gross estate for Federal estate tax purposes.[6]

The estate tax treatment of survival law proceeds is now identical to that of wrongful death proceeds, though this wasn't always the case. The IRS holds that under a survival law, the cause of action "survives the victim's death and passes to his personal representative to be pursued as an asset of the probate estate."[7] Prior to 1975, the IRS argued that because the decedent has the "power to designate who shall enjoy the proceeds it must follow that she has some interest in the property."[8] Arguably, the proceeds should therefore be included in the decedent's estate for estate tax purposes.

However, in 1975, after asserting the above argument and losing in several cases,[9] the IRS acquiesced, agreeing to follow the pro-taxpayer decisions. As such, the IRS no longer includes the value of survival proceeds in a decedent's gross estate. As will be discussed later, it's important to note that the 1975 revenue ruling specifically held that damages arising before an injured party's death (for example, pain and suffering based on a personal injury lawsuit) will be included in the decedent's gross estate.

Income tax consequences. Internal Revenue Code Section 104(a)(2) excludes from income, damages received on account of personal physical injuries or physical sickness. Thus, for income tax purposes, beneficiaries who receive proceeds from a wrongful death or survival lawsuit won't need to pay income tax on those proceeds if they were received "on account of" a personal physical injury or physical sickness (that is, the death resulted from some physical injury or sickness caused by the defendant).

Proceeds from wrongful death and survival lawsuits fall under different sections of the IRC. Wrongful death proceeds are received tax-free as damages received on account of personal physical injuries or physical sickness. No case law exists on the federal income tax consequences of survival law proceeds. However, it seems reasonable to assume that they will be excluded either in the same way as wrongful death proceeds, or as would proceeds from a decedent entitled to damages originating before his death. Assuming a physical injury or physical sickness, beneficiaries should receive survival law proceeds tax-free under either theory.

Proceeds under wrongful death laws that create causes of action for beneficiaries are received tax-free as long the damages are received "on account of" a personal physical injury or sickness.

Deceptively complex, the phrase "on account of" has been frequently litigated. Congress inserted the term "physical" twice into Section 104(a)(2) in 1996, along with language specifically including gross income damages received on account of emotional distress.[10] Legislative history and the IRS indicate that emotional distress damages resulting from a physical injury or physical sickness are received tax-free[11] and that physical injury or physical sickness damages resulting from emotional distress are fully taxable.[12] In fact, as long as the originating injury or sickness is physical, damages "that flow therefrom" are treated as damages received on account of personal physical injuries or physical sickness whether or not the recipient of the damages is the injured party.[13] Even spousal proceeds from a loss of consortium claim can be excluded when received on account of a personal physical injury or sickness of one's husband or wife.[14]

Proceeds from a wrongful death lawsuit brought by the decedent's beneficiaries are received more directly "on account of a personal injury or sickness" than proceeds from a loss of consortium claim, when a spouse is making what amounts to an emotional distress claim on account of the other spouse's death. Unsurprisingly, the IRS has repeatedly found that beneficiaries of wrongful death proceeds are entitled to receive them tax-free, whether received in a lump sum or via a structured settlement stream of periodic payments.[15]

The basis to exclude proceeds from a survival law

cause of action is less clear. Survival laws create causes of action that become assets of decedents' probate estates. An estate may exclude damages received for physical injury or physical sickness under Section 104(a)(2). But, do beneficiaries receive the damages from a decedent's estate on account of the decedent's physical injury or physical sickness? If so, the beneficiaries may exclude survival law proceeds from their gross income under Section 104(a)(2), as would the estate and as would the decedent had he lived. However, Treasury regulations hold that "damages" are amounts received "through prosecution of a legal suit or action, or through a settlement agreement entered into in lieu of prosecution."[16] It may be questionable whether beneficiaries of survival law proceeds receive "damages" under the regulatory definition.

It seems more plausible that beneficiaries of survival law proceeds receive them in the same fashion as do beneficiaries of a decedent with a pre-death created cause of action (for example, pain and suffering or a claim unrelated to decedent's death).

Pre-death Created Causes of Action

What about proceeds from a decedent's cause of action created prior to the decedent's death? The decedent may have been a plaintiff in a personal injury lawsuit that settled for a lump sum payment or payments over time or even one that failed to settle during the decedent's life.

Estate tax consequences. Proceeds from causes of action originating before the decedent's death, such as pain and suffering, become part of the decedent's gross estate. Thus, they may give rise to estate tax liability.

Although wrongful death and survival law proceeds aren't taxable because a decedent never had an interest in them, IRS rulings specifically caveat proceeds in which a decedent had an interest during life.[17]

For example, one revenue ruling in which the IRS acquiesced to the identical estate tax treatment of wrongful death and survival law proceeds explained:

> [W]here it can be established that such proceeds represent damages to which the decedent had become entitled during his lifetime (such as for pain and suffering and medical expenses) rather than damages for his premature death, the value of these amounts will be includible in the decedent's gross estate.[18]

Thus, in situations in which a decedent had an interest in a claim for pain and suffering before dying a wrongful death, or in a claim originating long before and unrelated to a decedent's death, resulting damages will be included in a decedent's estate. This is true whether the damages are or will be received in a lump sum payment or in periodic payments over many years.[19]

In the case of periodic payments, valuing the income stream that must be included in a decedent's gross estate can become very complicated. Beneficiaries of decedent lottery winners experience the same difficulty. Generally, property is included in a decedent's gross estate to the extent of the property's fair market value (FMV) on the date of the decedent's death, determined by the price a willing buyer would pay a willing seller when neither are compelled to buy or sell and when both have reasonable knowledge of the facts.[20]

The value of periodic payments is determined under tables prescribed by the Treasury Secretary, unless otherwise specified in regulations.[21] Regulations issued in 1995 provide that a "restricted beneficial interest," that is, an annuity or income interest "subject to any contingency, power, or other restriction," won't typically be valued under the prescribed tables.[22] Such an interest is to be valued based on all the facts and circumstances.[23] Court decisions before issuance of the regulations also looked to whether a taxpayer seeking to depart from the tables could substantiate a better method.[24]

Whether lottery and structured settlement payments are considered to be restricted beneficial interests becomes exceedingly important in measuring estate tax liability. For example, a structured settlement recipient's estate argued to the U.S. Court of Appeals for the Fifth Circuit, that the FMV of payments to which it was entitled equaled $1.2 million based on the facts and circumstances, rather than $2.4 million, as specified by the regulation tables. The difference in FMV resulted in over $400,000 of additional estate tax liability.[25]

Both lottery and structured settlement payments are frequently non-assignable pursuant to their agreements, though they're sometimes "factored" anyway.[26] Whether the limit on transferability constitutes a "restriction" for purposes of finding a "restricted beneficial interest" (thus allowing a facts-and-circumstances analysis), FMV has been frequently litigated. The IRS maintains that the limitation on assignability doesn't constitute a "restriction" because the annuitant retains the right

to receive all payments.[27]

Currently, there's a split among the circuits.[28] The Fifth and Sixth Circuits side with the IRS, finding no "restriction" and therefore that the regulation tables should be followed.[29] The Second and Ninth Circuits side with taxpayers, interestingly, in cases based on deaths before the addition to the regulations of the "restricted beneficial interest" exception.[30] Those taxpayers were allowed a facts-and-circumstances valuation when the tables would produce a substantially unrealistic or unreasonable result or when a more realistic and reasonable valuation method exists.[31]

Regardless of the valuation method, periodic payments can dramatically increase the size of a gross estate.

Income tax consequences. The operation of IRC Section 691 can result in income tax liability to an estate beneficiary. Section 691 includes in a beneficiary's gross income, payments received for tax purposes that a cash method decedent didn't, but would have, received for tax purposes prior to death.[32] For example, a decedent's deferred compensation payments are included in a beneficiary's gross income.[33] For purposes of personal injury awards and settlements, this means that beneficiaries may incur income tax liability by receiving proceeds from the decedent's original cause of action. However, payments that the decedent could have excluded from gross income don't constitute "income" to a beneficiary either. Beneficiaries who receive proceeds from a decedent's cause of action originating prior to the decedent's death incur income tax liability only to the extent that the decedent would have, if he had lived.

Beneficiaries of estates aren't taxed upon receipt of property. Thus, a lump sum settlement passed on wouldn't result in income tax to the beneficiary.

However, the same can't be said of settlements paid out over time. IRC Section 691 includes in a beneficiary's gross income "[t]he amount of all items of gross income in respect of a decedent which are not properly includible in respect of the taxable period in which falls the date of his death or a prior period ... ."[34] As noted, for example, payments to a beneficiary of a cash method decedent's deferred compensation are included in the gross income of the beneficiary.[35] Proceeds from contingent claims, such as personal injury causes of action, are also included as income in respect of a decedent.[36]

Fortunately for beneficiaries of decedents with causes of action existing prior to death, Treasury regulations hold that income in respect of a decedent isn't received when the proceeds would have been excluded from the decedent's gross income had he lived to receive them.[37] Thus, if the decedent would have received the damages on account of a personal physical injury, excludable under Section 104(a)(2), the beneficiary of such proceeds needn't include them under Section 691.[38] (See "Tax Consequences in a Nutshell," this page, for a summary of the taxability of various types of proceeds.)

Tax Consequences in a Nutshell

Damages won in certain lawsuits may be taxable

	Wrongful Death Proceeds		Survival Law Proceeds		Pre-Death Proceeds	
	Physical	*Emotional*	*Physical*	*Emotional*	*Physical*	*Emotional*
Estate Tax	Tax-free	Tax-free	Tax-free	Tax-free	Taxable	Taxable
Income Tax	Tax-free	Taxable	Tax-free	Taxable	Tax-free	Taxable

— *Jeremy Babener*

From Knowledge to Strategy

As is often the case with tax, too much knowledge can leave one paralyzed. Below are three examples that review the estate and income tax consequences of certain settlements, as well as some accompanying suggestions on how a practitioner might restructure the settlement to best serve a client.

Example 1: Wrongful Death Proceeds

John is killed in a car accident by a negligent driver. John's non-spouse beneficiary,[39] Janet, sues the driver under a wrongful death law and settles for $10 million.

Tax consequences: John never had an interest in the proceeds, so for estate tax purposes they don't enter his gross estate. Therefore, the estate incurs no estate tax liability. Because Janet will receive the damages on account of a physical injury, she may exclude them from her gross income. Therefore, she incurs no income tax liability.

Structured settlement: Janet and the casualty insurer could agree to a structured settlement of periodic payments to Janet. The insurer could assign liability to an assignment company, which would purchase an annuity

to fund Janet's stream of income. By doing so, Janet could benefit from the investment portion of the annuity without additional income tax liability, a significant tax benefit.[40] Even if the wrongful death cause of action had resulted from a nonphysical injury or sickness, thus resulting in taxable proceeds, the use of a structured settlement would defer income tax liability.[41]

Example 2: Survival Law Proceeds

John is killed in a car accident by a negligent driver. John's representative sues the driver under a survival law and settles for $10 million. The estate distributes the entire settlement proceeds to Janet, a non-spouse beneficiary.

Tax consequences: John never had an interest in the proceeds, so they don't enter his estate. Therefore, the estate incurs no estate tax liability. Either because Janet receives the damages on account of a physical injury, or because inheritance is excludable and a beneficiary needn't include in her income amounts that the decedent could have excluded, Janet may exclude the damages from her gross income. Therefore, she incurs no income tax liability.

Structured settlement: As was the case in Example 1, the use of a structured settlement could provide additional value to the beneficiary.

Example 3: Decedent with a Claim Prior to Death

Jane, an unmarried woman, was shot and permanently paralyzed by her neighbor. She sued the neighbor for battery and agreed to a non-assignable structured settlement of $500,000 for 32 years. Two years later, in January 2011, Jane died of a heart attack unrelated to the gunshot injury. The estate distributed its entirety to Jane's non-spouse beneficiary, Frank, consisting only of the right to receive 30 years of structured settlement payments.

Tax consequences: Jane had an interest in the damages while still alive and thus they enter her gross estate. Depending on the jurisdiction, her estate will either value the right to receive 30 years of $500,000 payments based on the Treasury regulation tables or based on the facts and circumstances (accounting for non-assignability). Under the regulations, the payment's value is $10,606,050.[42]

Assuming, generously, that Jane used none of her unified credit during her life, the first $5 million of value isn't subject to the estate tax. The remaining amount, $5,606,050, results in estate tax liability of $1,962,117.50. As in Example 2, the beneficiary (Frank) incurs no income tax liability under one of the two alternative theories (the exclusion of Section 104(a)(2) or the exclusion of Section 102 and no inclusion under Section 691).

Settlement negotiations: Jane's attorney focused, at least in part, on the interests of Frank, as Jane's beneficiary. Jane could likely have settled for a larger annual payout limited to the span of her life, rather than for a 32-year term. In fact, this would have resulted in no estate tax liability, as no property or right to collect would have existed beyond Jane's life. However, foreseeing the possibility of Jane's premature passing, her attorney negotiated a settlement to secure an economic benefit for Frank. Apart from the immediate estate tax liability, Frank will benefit from the deferral and interest component of the periodic payments, which he will receive free of income tax.

If Frank possessed any claim as a result of Jane's physical injury, such as emotional distress, Jane's attorney would have been wise to include Frank as an original plaintiff. Any portion of the settlement paid to Frank wouldn't be included in Jane's gross estate for estate tax purposes. Assuming that Jane received more than she would use during life, and that the defendant was only willing to pay a finite amount whether to one or two plaintiffs, apportioning a reasonable amount directly to the soon-to-be beneficiary would reduce estate tax liability. In other personal injury tax contexts, allocations are respected unless shown to be unreasonable.[43] While the beneficiary of a near-death plaintiff might be hesitant to accept settlement proceeds that the plaintiff would otherwise receive, doing so may diminish the subsequent tax burden.

Alternatively, a structured settlement between a defendant and co-plaintiffs could name the more-injured plaintiff as the primary beneficiary of the settlement payments and the less- (emotionally) injured plaintiff as a contingent beneficiary, only to receive payments upon the first plaintiff's death. Because both plaintiffs possessed claims against the defendant, the design of such a settlement is arguably similar to the plaintiffs' combined purchase of jointly held property. Treasury regulations hold that a decedent's gross estate in such a situation includes only the portion of property corresponding to the decedent's purchase.[44] The estate would argue that the present value of payments made beyond the more-injured plaintiff's death represent liability value to the less-injured plaintiff at the time of settlement.

Were the settlement already completed, the attorney might advise the plaintiff that in each year succeeding the settlement she make gifts of any unneeded funds to her intended beneficiaries in amounts not exceeding $13,000 per donee.[45] The lifetime unified credit is only reduced by gifts in excess of the $13,000 annual exclusion. For example, with actual needs of $200,000 per year for her care, Jane could gift away up to $300,000 per year without incurring gift tax, thus reducing her later gross estate. Of course, a short life would render this plan less effective. Moreover, she would only wish to effect this plan with intended beneficiaries. Because the annual exclusion is small, Jane would need many intended beneficiaries for the plan to substantially reduce her gross estate. Still, a gift of $13,000 in the year of settlement might grow to $30,000 by the time of her death. Thus, gifting early would likely save more than the gift amount multiplied by the estate tax rate.

Unfortunately, even if a plaintiff takes these steps, there may be significant estate tax liability without any estate liquidity. This will result when the estate's only significant asset is a stream of periodic payments. In that case, the request of an extension may be appropriate based on a showing of "reasonable cause."[46] Alternatively, a plaintiff may wish to purchase a life insurance policy to provide liquidity.[47] To avoid the gross estate from including such proceeds for estate tax purposes, a plaintiff could contribute the policy to an irrevocable life insurance trust.[48] Without such liquidity, or an extension, the representative of the estate may be forced to sell a portion of the future stream of income at a significant discount. (See "Practice Tips," this page.)

PRACTICE TIPS:

- Joining intended beneficiaries as co-plaintiffs can decrease estate tax liability.
- Purchasing a life insurance policy can create much needed estate liquidity.
- Agreeing to a structured settlement can add value by deferring receipt of income and by allowing the recipient to benefit from interest growth tax-free.

The above strategies are but a few arrows in the quiver of a competent trusts and estates attorney. Other alternatives exist that may mitigate estate tax liability such as grantor retained annuity trusts and intentionally defective grantor trusts. The first is designed to transfer value to a beneficiary equal to the difference between the IRS' assumed rate of interest and the actual rate of interest obtained. The second invites gift tax of transferred assets at today's value, rather than estate tax at the likely higher value upon the grantor's death. In addition, it allows the trust to directly receive income derived from the assets and the grantor to remain responsible for the income taxes associated with the trust.

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Endnotes

1. This article is limited to federal estate and income tax consequences.
2. N.J. Stat. Ann. Section 2A:31-4 (West 2008).
3. Conn. Gen. Stat. Section 52-555(a) (West 2003).
4. Revenue Ruling 75-127, 1975-1 C.B. 297.
5. Rev. Rul. 54-19, 1954-1 C.B. 179, made obsolete in part by Rev. Rul. 2007-14, 2007-1 C.B. 747 (estate tax holding not made obsolete).
6. *Ibid.*
7. *Ibid.*
8. Private Letter Ruling 6706191560A (June 19, 1967).
9. *Connecticut Bank and Trust Co. v. United States*, 465 F.2d 760 (2d Cir. 1972); *Lang v. U.S.*, 356 F. Supp. 546 (S.D. Iowa 1973); *Vanek v. U.S.*, 360 F. Supp. 116 (S.D. Iowa 1973).
10. Small Business Job Protection Act of 1996, Pub. L. No. 104-188, Section 1605, 110 Stat. 1755, 1838 (1996).
11. PLR 200041022 (Oct. 17, 2000) (settlement proceeds paid to a couple for emotional distress caused by physical and sexual assaults to the wife are "on account of" personal physical injuries or physical sickness). The Internal Revenue Service has said that "direct unwanted or uninvited physical contacts resulting in observable bodily harms such as bruises, cuts, swelling, and bleeding are personal physical injuries." *Ibid.* If the injury or sickness that caused death wasn't physical (such as verbal harassment that caused a heart attack), the proceeds may be found not to have been received "on account of" a personal physical injury. IRC Section 104(a)(2); House Conference Report No. 104-737 (Conf. Rep.), at p. 301 n. 56 (1996). However, recent Tax Court rulings suggest that such proceeds might

be received tax-free after all. *Parkinson v. Commissioner,* Tax Court Memo 2010-142 (June 28, 2010); *Domeny v. Comm'r*, T.C.M. 2010-9 (Jan. 13, 2010).

12. Conf. Rep., *supra* note 11, "It is intended that the term emotional distress includes symptoms (e.g., insomnia, stomach aches, stomach disorders) which may result from such emotional distress."
13. *Ibid; see* Joint Committee on Taxation 105th Congress General Explanation of Tax Legislation, enacted in 1998, *www.jct.gov/publications.html?func=startdown&id=1213.*
14. PLR 200121031 (Feb. 16, 2001); Conf. Rep., *supra* note 11. Interestingly, before Section 104(a)(2) specifically excised punitive damages from its gross income exclusion, the Supreme Court held that such damages aren't received on account of personal injuries. *O'Gilvie v. U.S.*, 519 U.S. 79, 82 (1996).
15. Rev. Rul. 2003-115, 2003-2 C.B. 1052; PLR 201022011 (Feb. 25, 2010); PLR 9017011 (Jan. 24, 1990).
16. Treas. Regs. Section 1.104-1(c).
17. Rev. Rul. 75-127, 1975-1 C.B. 297.
18. Rev. Rul. 69-8, 1969-1 C.B. 219; IRS Technology Advisory Memo 98-11-006 (Nov. 24, 1997) (award to plaintiff's trust included in plaintiff's estate upon his death); *Estate of Jeanne M. Houston v. Comm'r*, T.C.M. 1982-362 (June 28, 1982) (claim of wrongful death for husband included in the widow's estate upon her subsequent death).
19. *See* IRC Section 2033 (including in the gross estate the value of property to the extent of decedent's interest) and Section 2039(a) (including in the gross estate, among other property, payments receivable by a decedent's beneficiary if payable pursuant to an agreement for a period beyond the decedent's death).
20. Treas. Regs. Section 20.2031-1(b). The estate executor may elect an alternative valuation under Section 2032.
21. IRC Section 7520(a)-(b). *See* Treas. Regs. Section 20.7520-7 (providing the valuation tables).
22. Treas. Regs. Section 20.7520-3(b)(ii).
23. Treas. Regs. Section 20.7520-3(b)(iii).
24. *Shackleford v. U.S.*, 262 F.3d 1028, 1033 (9th Cir. 2001).
25. *Anthony v. U.S.*, 520 F.3d 374, 376-77 (5th Cir. 2008) (finding the regulatory value to be correct).
26. For a discussion of "factoring," *see* Jeremy Babener, "Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History," 13 *N.Y.U. J. Legis. & Pub. Pol'y*, 1, 40-41 (2010).
27. TAM 96-16-004 (April 19, 1996).
28. For a full exposition on the rationales of and differences among the circuits, *see* Ted D. Englebrecht and Fred L. Coleman, "Valuation of Lottery Prize Payments for Estate Tax Purposes," 8 *Prac. Tax. Strategies* 3, 65 (2010); Wendy C. Gerzog, "*Negron*: Circuits Now Split 2-2," *Tax Notes*, May 11, 2009.
29. *Negron v. U.S.*, 553 F.3d 1013 (6th Cir. 2009); *Anthony, supra* note 25.
30. *Estate of Gribauskas v. Comm'r*, 342 F.3d 85 (2d Cir. 2003); *Shackleford, supra* note 24.
31. *Estate of Gribauskas, supra* note 30 at pp. 85, 89; *Shackleford, supra* note 24.
32. *See* PLR 8740042 (July 8, 1987).
33. IRC Section 102(a).
34. IRC Section 691(a).
35. Treas. Regs. Section 1.691(a)-2(b) (Example 1). The regulations provide the recipient a gross income deduction for the amount of estate taxes paid. Treas. Regs. Section 1.691(b)-1.
36. *See* Rev. Rul. 55-463, 1955-2 C.B. 277 (proceeds from patent litigation ongoing at the plaintiff's death to be includible to his estate under Section 691).
37. Treas. Regs. Section 1.691(a)-1(d).
38. *See* PLR 8740042 (July 8, 1987).
39. The gross estate includes the value of property transferred to a spouse, but an unlimited estate tax marital deduction is generally available. *See* IRC Sections 2034 and 2056(a).
40. Receipt and investment of a lump sum settlement can give rise to income or gain in the same fashion as the investment of any other principal. *See* Rev. Rul. 79-313, 1979-2 C.B. 75 (*citing* Rev. Rul. 65-29, 1965-1 C.B. 59).
41. Surprisingly, industry data suggests that more than 95 percent of structured settlements stem from a personal physical injury or physical sickness cause of action. Daniel W. Hindert *et al., Structured Settlements and Periodic Payment Judgments,* Section 1.03[1] (2010) (approximately $150 million of some $5.5 billion measured by structured settlement annuity premiums).
42. Treasury regulations provide that the present value of the interest is the product of the aggregate amount payable annually ($500,000), multiplied by the appropriate annuity factor (20.2121). The correct annuity factor can be found on the IRS' website based on the month and year of valuation (January 2011) and the number of years during which the annual payment will be made (30). Treas. Regs. Sections 20.2031-7(d)(2)(iv)(A) and 20.7520-1(c)(1); IRC, Section 7520 Actuarial Tables, *www.irs.gov/businesses/small/article/0,,id=112482,00.html.*
43. Rev. Rul. 75-230, 1975 C.B. 93.
44. Treas. Regs. Section 20.2040-1(a), (c) (Example 2). The estate executor bears the burden of demonstrating that the property wasn't purchased by the decedent alone.
45. Rev. Proc. 2010-40, 2010-46 I.R.B. 663.
46. IRC Section 6161(a)(2).
47. Life insurance proceeds receivable by or for the benefit of the estate are included in the decedent's gross estate. IRC Section 2042(1); Treas. Regs. Section 20.2042-1(a). Proceeds receivable by others may be includible under Section 2042(2) if the decedent holds incidents of ownership.
48. By avoiding any incidents of ownership, the plaintiff can prevent the life insurance proceeds from entering his gross estate under Section 2042(2). However, under Section 2035, proceeds would be includible in the gross estate if the plaintiff dies within three years of contributing the policy. A better alternative would be to contribute cash to the irrevocable trust, which can purchase the life insurance policy. Of course, either transfer would reduce the plaintiff's unified credit unless the value of the transfer per donee falls below the $13,000 annual exclusion. *See* Section 2511; Treas. Regs. Section 25.2511-1(h)(8).