

STRUCTURED PAYMENTS

**STRUCTURED PAYMENT PLANS ENHANCE YOUR CLIENT'S WEALTH,
DEFER INCOME TAXES,
AND PROVIDE ASSET PROTECTED PAYMENT STREAMS.**

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FOREWORD

Structured Payment Plans are powerful time-tested financial tools that are now being made available for compensation and commercial transactions. The tax and legal foundations on which the concepts and programs described in this manual are built are settled law. Structured Payments have been used for many years in personal injury settlements and are a widely used means of providing tailored tax-advantaged income streams to the obligees.

The program you have the opportunity to make available to your clients is unique in that it offers your clients the opportunity to apply to compensation and to commercial transaction the same rules that apply to personal injury settlements. The underlying legal and tax principles are not unique, it is the application of these principles to commercial transactions through a structure controlled by and guaranteed by major insurance company that is unique.

Structured payment plans are not complex. They are easily understood. Keep reading. Your client and you will be pleased with this plan that will allow you to enhance your client's personal wealth, improve their asset protection and, in many cases, significantly decrease their immediate tax burden resulting in immediate cash flow.

TABLE OF CONTENTS

Overview of a Structured Transactions	
Transaction flow	4.
Income tax aspects	
Asset protection aspects	
Financial impact illustrations	
Payments to a non-owner	5.
Payments to owners of “pass-through” entities	6.
Sale of a long-term capital gain asset	7.
How to obtain an illustration for your client	9.
Tax and Legal Authorities	10.
Endnotes	11.

OVERVIEW OF STRUCTURED TRANSACTIONS

Seen at their most basic level, the steps in establishing a structured transaction are very simple:

1. The payor (buyer/employer/contractor) pays the agreed funds to the structured payments provider (obligor) who contracts to pay specific amounts at specific dates to the obligee.
2. The obligor purchases an annuity from the insurance company (parent company of the obligor) sufficient to fulfill its future payment obligation to the obligee. The annuity purchased is for the amount of the future payments agreed between the payor and obligee.¹
3. The obligor instructs the insurance company to make the annuity payments to the obligee on behalf of the obligor.²

The income tax aspects of the transaction are also easily understood:

1. The payor (buyer/employer/contractor) hires the structured payments provider (obligor) to fulfill the payor's future obligations. The payment of the required premium results in a deductible business expense essentially because all payment issues are accomplished for the payor. The payor has made a cash payment that satisfies its obligations.
2. The contract between the payor and the obligor require the payment of specific amounts on specific future dates to the obligee.
3. The obligee is the unsecured general creditor of the structure provider, but receives a security interest in the underlying annuity.
4. On the prescribed dates, the obligee is paid the contracted amounts. As the obligee is an unsecured general creditor of the obligor that has an obligation to pay specified amounts on specified future dates, the payments are not considered as earned until paid.
5. Although the obligor has purchased an annuity to support its own obligation to the obligee, the obligee is not technically the recipient of annuity payments. The obligee is simply receiving payment amounts that were determined at the date the structured program was entered into. Therefore, these payments do not contain an interest component and are accounted for as if they were original proceeds. (This is easily understood by reviewing the illustrations.)
6. The tax residence of the obligee when each payment is made will determine whether the payment is subject to state and/or local taxes as the funds are not earned until paid. The tax residence of the payor, at the time the payment is made to the obligor, will determine the tax treatment.³

The asset protection aspects of the program are clear and very effective for payor and obligee:

1. The payor has paid funds in fulfillment of an ordinary and necessary business expense and the creditors, apart from fraud, have no right or claim on the funds paid into the structure. Even to the extent that the payor utilizes its general credit standing or pledges assets or income to obtain the funds to be paid into the structure, apart from proven fraud, the creditors of the payor will have no right of claim against the funds so paid.
2. The obligee is the unsecured general creditor of the offshore entity that is the obligor. Even though the obligor is a wholly owned subsidiary of a major US insurance company, any claims against the obligations of the offshore obligor to the obligee would need to be prosecuted in the jurisdiction of the structure provider and under its laws.
3. In the case of deferred compensation, the amounts to be paid to the obligee in the future are not considered earned until the time of payment. Therefore, any attempt by a creditor to garnishee or otherwise claim against those payments would need to be prosecuted for each payment.
4. In the case of a structured installment sale, any claims against the future payments would likewise need to be prosecuted in the jurisdiction of the structure provider and against each payment.
5. To the extent that the structured program was initiated by a single individual, the future payments would not ordinarily become a part of any marital estate or become community property.

FINANCIAL IMPACT ILLUSTRATIONS

The significant financial benefit available through the use of Structured Payments Plans is illustrated by the tables below. The calculations are principally designed to illustrate the principles and therefore would need to be modified to fit a particular client's own Federal and state tax status.

PAYMENTS TO A NON-OWNER

Table 1 illustrates the benefits to the obligee that does not have a direct profits interest in the paying entity. Examples might be Jury Awards that would be taxable income to the obligees, including counsel, signing bonuses, endorsement fees, or essentially any other type of taxable compensation. (A separate, though similar, program is available for non-taxable compensation).

	<u>Current Payment</u>	<u>Structured Payment</u>
Payment	\$2,000,000	\$2,000,000
Federal Income Tax (35%)	-700,000	
Medicare taxes (2.9%)	-58,000	
State & local income taxes (8%)	<u>-160,000</u>	
Available for investment	<u>\$1,082,000</u>	<u>\$2,000,000</u>

Total payout assuming 6% pre-tax earnings rate

Payments begin in 20 years, then 15 years certain		
Tax basis	\$1,082,000	\$ 000
Earnings/Initial payment + earnings	2,931,000	7,418,000
Tax on payments (35+8% / 35+8+2.9%)	<u>-1,260,000</u>	<u>-3,405,000</u>
Proceeds, after taxes	<u>\$2,753,000</u>	<u>\$4,013,000</u>
 Immediate payments for 30 years certain		
Tax basis	\$1,082,000	\$ 000
Earnings/Initial payment + earnings	1,242,000	4,295,000
Tax on payments (35+8% / 35+8+2.9%)	<u>534,000</u>	<u>1,971,000</u>
Proceeds, after taxes	<u>\$1,790,000</u>	<u>\$2,324,000</u>

The financial impact of the structured payment program is significant. In the first example, the obligee will receive approximately 45% more in after tax funds. In the second example, the client will receive approximately 30% more in after tax proceeds than without the structured payments plan..

If the obligee were resident in a non-tax or lower tax jurisdiction when the payments were received through the structured program, the financial impact would be even more significant.

To the financial impact the value of the asset protection features must be added the ability to tailor the payment stream from the structured program to compliment any other pension or retirement program to provide maximum benefits for your clients.

PAYMENTS TO AN OWNER

Table 2 illustrates the economic benefit to an owner of a pass-through entity who places \$200,000 per year into the structured payment for 5 years and then begins a 20 year certain payment stream. For the purpose of this illustration, it is assumed that the client has sufficient other income so that the payments in question are all at maximum rates.

	<u>Cost to Business</u>	<u>Benefit to Owner</u>
Year 1	\$200,000	\$200,000
Tax Savings (35% + 2.9% + 8%)	<u>91,800</u>	
Net Cost to Business	<u>108,200</u>	
Year 2	\$200,000	\$200,000
Tax Savings (35% + 2.9% + 8%)	<u>91,800</u>	
Net Cost to Business	<u>108,200</u>	
Year 3	\$200,000	\$200,000
Tax Savings (35% + 2.9% + 8%)	<u>91,800</u>	
Net Cost to Business	<u>108,200</u>	
Year 4	\$200,000	\$200,000
Tax Savings (35% + 2.9% + 8%)	<u>91,800</u>	
Net Cost to Business	<u>108,200</u>	
Year 5	\$200,000	\$200,000
Tax Savings (35% + 2.9% + 8%)	<u>91,800</u>	
Net Cost to Business	<u>108,200</u>	
Total after tax cost to business / Deposits in fund	<u>\$541,000</u>	\$1,000,000
Growth in fund (assuming deposits at end of year		<u>75,000</u>
Values in plan at the end of year 5		<u>\$1,075,000</u>
Gross payments for 240 months		\$1,848,400
Taxes due (35% + 2.9% + 8%)		<u>848,400</u>
After tax proceeds		<u>\$1,000,000</u>
If after tax payment from business were placed into a conventional annuity program on the same terms	\$541,000	
Growth in value in plan at the end of year 5	<u>57,700</u>	
Value at end of year 5	<u>\$598,700</u>	
Gross payments for 240 months	\$1,029,400	
Taxes due (35% + 8%) on growth of \$488,400	<u>210,000</u>	
After tax proceeds	<u>\$819,400</u>	

By utilizing the structured payments program, the client will receive approximately 22% more after tax dollars than would have been received if the dollars paid into the structured payment program had been paid to the client and then invested in a conventional annuity on the same terms as the structured plan.

The benefit to the client includes the asset protection attributes of the program and the fact that the structured payment program allows the payment stream to be tailored to compliment any other pension or retirement program to provide maximum benefits for your clients.

Payments to an owner/employee as deferred compensation are not ERISA type payments and therefore inclusion in the program may be determined on a selective basis. Payments into the structured deferred compensation program may be made without consideration of qualified plans that may be in effect.

**FINANCIAL IMPACT OF STRUCTURED PAYMENTS PROGRAM
WITH THE SALE OF A LONG-TERM GAIN PROPERTY**

<u>Without Structured Payments Program</u>		<u>With Structured Payments Program</u>	
Selling Price	<u>\$2,000,000</u>	Selling Price	Cash Amount \$1,000,000
Cost	<u>\$1,000,000</u>		SPP Value <u>2,720,160 (a)</u>
Depreciation	<u>300,000</u>	Total Selling Price	<u>\$3,720,160</u>
Basis	<u>\$700,000</u>		
Recapture	<u>\$300,000</u>	Cost	\$1,000,000
Long-Term Capital Gain	<u>\$1,000,000</u>	Depreciation	<u>300,000</u>
Outstanding Mortgage	<u>\$700,000</u>	Basis	700,000
		Recapture	<u>300,000</u>
Tax on Recapture @40%	\$120,000	Revised Basis	<u>\$1,000,000</u>
Tax on LTCG @ 15%	<u>150,000</u>	Outstanding Mortgage	<u>\$700,000</u>
Total Tax	<u>\$370,000</u>		
		Allocation of adjusted basis to Sales Price:	
		Revised basis	<u>700,000</u>
		Gross selling price	3,720,160
		Basis as % of selling price	18.8% (b)
Annuity Plan	15 years of equal payments after 10 years		
	Earnings rate of 6%		
	Ordinary tax rate of 40%		
	LTG tax rate of 15%		

Description	<u>Without SPP</u>		<u>With SPP</u>	
	<u>Cash Proceeds</u>		<u>Cash Proceeds</u>	<u>SPP Amount</u>
Gross Sales Price (cash/calculated)	\$2,000,000		\$1,000,000	\$2,720,160 (a)
Less: Basis (actual/calculated @ 26.8%)(b)	700,000		188,000	512,000 (b)
Depreciation recovery	<u>300,000</u>		<u>300,000</u>	n/a
Long-term gain	<u>\$1,000,000</u>		<u>\$512,000</u>	<u>\$2,208,160</u>
Cash/Structured payments program proceeds	\$2,000,000		\$1,000,000	\$2,720,160
Less: Tax of Depreciation recovery (40%)	120,000		120,000	n/a
Long-term capital gains tax (15%)	150,000		76,800	331,224
Less: Mortgage payoff	<u>700,000</u>		<u>700,000</u>	n/a
Net proceeds after current tax	<u>\$930,000</u>		<u>\$103,200</u>	<u>\$2,388,936</u>
Amount placed in annuity/structured program	<u>\$930,000</u>		<u>\$103,200</u>	<u>\$1,000,000 (c)</u>
Value in 10 years with tax deferred growth	<u>\$1,665,488</u>		<u>\$184,815</u>	<u>\$1,790,847</u>
Total payments over 15 years	\$2,529,720		\$280,717	\$2,720,160 (a)
Cost of Annuity	<u>930,000</u>		<u>103,200</u>	<u>00</u>
Taxable amount	<u>\$1,599,720</u>		<u>\$177,517</u>	\$2,720,160
Less: Recovery of adjusted basis (26.8%)	n/a		n/a	512,000 (d)
Taxable amount				<u>\$2,208,160</u>
Less: Tax at 40% ordinary / 15% LTGC	<u>\$639,888</u>		<u>\$71,007</u>	<u>\$331,224</u>
Total proceeds	\$2,529,720		\$280,717	\$2,720,160
Less: Tax Costs	639,888		71,007	331,224
Net proceeds of transactions	<u>\$1,889,832</u>		<u>209,710</u>	<u>2,388,936</u>
After tax proceeds with SPP			<u>\$2598,646</u>	
After tax proceeds without SPP			<u>1,889,832</u>	
Gain by using SPP			<u>\$ 708,814</u>	

Utilizing the structured payments program results in a net return that is more than 37% greater than without the program and provides the seller with certain asset protection features that may not otherwise be available. In addition, as payments are not earned until paid by the program, each payment would be taxable at the rates and in the jurisdiction in which the client resides at the time of the payment, which could result in even greater returns through the program.

EXPLANATORY NOTES FOR SALE OF LONG-TERM GAIN PROPERTY:

- (a.)** The structure of the program allows the total proceeds of the transaction to be accounted for as original proceeds of the transaction. In simple terms, the buyer agrees to pay the gross amount and hires the structured payments company to fulfill its obligation for an amount equal to the cash that would have been paid to the seller if the SPP were not used.
- (b.)** The adjusted basis of the property is allocated to the two divisions of the transactions separately from the recovery of depreciation which must be accounted for in the year of sale. The gross selling price is the gross amount that the seller will receive over the life of the program, including cash at closing.
- (c.)** This \$1,000,000 is the amount the buyer pays to purchase the stream of payments that will be made to the seller by the structured payment provider. This amount together with the cash paid at closing of \$1,000,000 equal the cash selling price of the property.
- (d.)** This is the allocation of the adjusted basis.

HOW TO OBTAIN AN ILLUSTRATION FOR YOUR CLIENT

To obtain an illustration for your client, please provide the following information by e-mail to

Creative Asset Protection Strategies, Inc.
David W. Southwell
david@capstrategies.com or Fax: 305-620-9738

1. Your name
2. Your telephone and e-mail address or fax number
3. A description of the amounts and tax aspects of the transaction to be illustrated, to include:
 - a. Type of transaction – compensation, sale of an asset, sale of a practice/business, etc.
 - b. Client's basis in asset, if any.
 - c. Depreciation to be recaptured, if any
 - d. Dollar amount of transaction
 - e. Intended dates of payment of amount(s) by employer or purchaser
 - f. Income tax rates applicable to initial, and any subsequent payments into the structured payment program for illustration
 - g. Income tax rates to be applied to payments to obligee
 - h. Period of time over which to make payments to obligee. Please give a full description of the client's plan for receiving payments. Payments may be structured as desired with varying amounts from year to year or with skipped payments or a balloon payment.
 - i. Any other information that you feel may be helpful in preparing the illustration for your client

Tax and Legal Authorities for Structured Payments Plan

The tax and legal foundation upon which this program is based is settled law. We have listed a number of references below that will provide you with support for the tax positions taken.

The actual flow of the funds in a transaction is as follows:

1. The agreed funds are paid to the Barbados corporation (obligor) that has been contracted by the employer or other payor of funds to make distributions on future dates to the obligee.
2. The Barbados corporation immediately purchases a fixed annuity, at then current rates, that will satisfy the Barbados corporation's obligations to the obligee. This annuity is purchased from the major US insurer that is the parent company of the Barbados corporation and is payable to the Barbados corporation (obligor).
3. The Barbados corporation directs the US insurer to make the payments directly to the obligee on behalf of the obligor.
4. The obligee is given a security interest in the annuity that is payable to the obligor.
5. Payments are made at the prescribed dates and in the prescribed amounts.

The principal issues to be considered, from a tax and legal aspect, are spelled out in clear language in *Childs v. Commissioner*, 103 T.C. 634 which was filed November 14, 1994 and affirmed without opinion 89 F. 3d 856 (11th Cir. 1996)

Other references of interest include the following list:

Code & Regulations

1. IRC §451(a)
2. IRC §83
3. Treas. Reg. §1.83-1

Revenue Rulings

1. Rev. Rul. 82-122
2. Rev. Rul. 75-457
3. Rev. Rul. 75-25
4. Rev. Rul. 74-157

Cases

1. *Minor v. U.S.*, 772 F.2d 1472 (9th Cir. 1985)
2. *Cunningham v. Commissioner*, 44 T.C. 103 (1965)
3. *Sproull v. Commissioner*, 16 T.C. 244 (1951)

Private Letter Rulings

1. PLR 200226018
2. PLR 200138006

Barbados-US Tax Treaty

1. Article 18

Endnotes
Structured Payments Plan

¹ In the case of the sale of an asset, the selling price should actually be calculated as the sum of the current and future payments to be received by the seller. When calculating gain in the transaction, the total of these payments should be utilized to determine both recapture of depreciation and the amount of short or long-term gain. The payments collected are treated as original proceeds without any interest component. (This is the same treatment given to structured personal injury payments. If the plaintiff collected the full amount of his or her settlement currently, the plaintiff would have no taxable income because personal injury claims are generally not taxable. If they then invested those funds in an annuity, the earnings from the annuity would be taxable income. By contrast, because of the construction of the structured program, if the plaintiff accepted a stream of payments over a period of years, no portion of the payments would be taxable to the plaintiff as interest income. However, the financial obligation of the party making the settlement would be the present value of that stream of payments, and that amount would be paid to the insurance company hired to make the future payments. This is exactly what happens with commercial transactions. The seller agrees to accept a series of future payments. The buyer “hires” the structured payments provider to make those payments for the present value of the stream.)

² It is an important distinction that the payor (buyer/employer/contractor) is not purchasing an annuity on the behalf of the obligee. To do so would be an event taxable to the obligee. The structured payments provider (obligor) does not make annuity payments to the obligee; the obligee (seller/employee/contracted party) is not an annuitant. The obligee is an unsecured general creditor of the obligor and has no rights to appoint an alternate obligee or to otherwise alter the structure once established (although such might be accomplished in special hardship cases). The obligor (which is the subsidiary of a major US insurance company that has guaranteed its obligations, has the duty to provide the financial means to fulfill its future obligations to the obligee. The obligor fulfills this responsibility by purchasing an annuity from the insurance company. The annuity is the property of the obligor and is payable to the obligor. The obligor then instructs the insurance company to make the payments to which it is entitled to the obligee on its behalf and provides the obligee with a security interest in the annuity.

³ Obligees that reside in a jurisdiction that has a state and/or local income tax at the time the plan is entered into, but reside in a jurisdiction with a lesser rate, or no state and/or local income taxes will find an even greater return from the structured payments plan than is reflected in the various charts and tables in this booklet by the spread in the total tax rates and by the earnings on that spread in rates.