

Special Focus: Structured Settlements

Treasury decides to pass on single-claimant qualified settlement fund guidance for now

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Late last month, the Treasury released its list of prioritized action items. Conspicuously absent, at least from the perspective of settlement planners and the structured settlement industry, was upcoming guidance on the tax treatment of single-claimant qualified settlement funds (QSFs).

Such guidance has been on the Treasury's "to-do list" since 2004, after it received opposing appeals from the Society of Settlement Planners and the National Structured Settlements Trade Association. The question is whether a single-claimant QSF can receive defendant monies and act as a party to a structured settlement without sacrificing the relevant claimant's eligibility to the structured settlement tax subsidy.

In a structured settlement, a defendant agrees to make periodic payments to plaintiffs over time, rather than in a single lump sum. Under certain conditions, §§ 104(a)(2) and 130(c) of the Tax Code allow a defendant to transfer the liability for these payments to a third party for a deductible sum, and a plaintiff to receive the third party's purchased annuity payments (the principal and investment portion) tax-free. The Joint Committee on Taxation calls the tax-preferred status of structured settlements a "tax subsidy."

A QSF is a temporary fund into which a defendant in certain circumstances can deposit settlement monies, rather than paying them directly to plaintiffs. The defendant can then take an immediate deduction, as if the settlement had been made directly with the plaintiffs.

Under § 468B of the Tax Code and accompanying revenue procedure, plaintiffs then negotiate (so to speak) with the QSF administrator to structure a settlement that is still eligible for the structured settlement tax subsidy.

Without the QSF regulatory structure withholding control over the transferred monies from a personal injury claimant, plaintiffs would receive "economic benefit" of the monies, and thus taxable income. For this reason, Robert Wood, author of a treatise on QSFs, calls the entity a "tax-free way station."

For quite some time, those in the structured settlement industry have debated whether a QSF and the structured settlement tax subsidy can be used together by a "single-claimant" (a single plaintiff, as opposed to a case of multiple plaintiffs, such as a mass tort action, though some argue that liens on a single plaintiff's claim create a multiple-claimant case). Legal arguments have revolved around whether economic benefit is received.

Where multiple claimants, and thus possibly competing interests, are not involved, some have argued that the transfer to a QSF represents an unconditional and irrevocable transfer to the claimant. If the existing QSF regulatory structure does not prevent this from being the case (a hotly contested fact), transfers to single-claimant QSFs would withhold eligibility to the structured settlement tax subsidy for structured settlements between single-claimants and QSFs.

Some have argued, including this author, that the Treasury should issue guidance holding single-claimant QSFs to be capable of structuring settlements where the resulting stream of income is received tax-free, as multiple-claimant QSFs are. The legal and policy arguments involved are discussed further in a 2004 article by



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Dick Risk, *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant*, and a forthcoming article by this author, *Structured Settlements and Single-Claimant Qualified Settlement Funds: Regulating in Accordance with Structured Settlement History*. (draft available at <http://ssrn.com/abstract=1474922>).

Chief among the policy rationales for such guidance is the explicit approval of an already used settlement procedure that provides increased time and control over the structuring process to personal injury plaintiffs and claimants.

Wood, author of the recently released treatise *Qualified Settlement Funds and Section 468B* has consistently recommended that the use of single-claimant QSFs be avoided without Treasury clarification, though he believes that the regulations "seem to allow the possibility of the single claimant QSF."

Risk, frequent QSF administrator and author of multiple articles discussing QSFs, argues that § 468B, revenue procedure, and economic benefit case law firmly allow single-claimant QSFs to structure settlements without triggering economic benefit. Though he calls for Treasury guidance to explicitly confirm his view, he argues that practitioners need not wait for such clarification before pursuing single-claimant QSFs.

How we got here, and what the new priority guidance plan changes

As early as 2001, the issue had been discussed at Treasury, though with no conclusion reached. In 2003, the Society of Settlement Planners called on the Treasury to act through its representation, Skadden Arps. The firm's assigned legal team included two former IRS Chief Counsels. The National Structured Settlements Trade Association opposed such regulations, providing a memo to that effect by attorneys at Dewey Ballentine, including a former Chief Counsel to the U.S. House Committee on Ways and Means.

Likely as a result of the correspondence, the Treasury listed the single-claimant QSF issue on its "to-do list" (the Priority Guidance Plan) in 2004. It has remained on that list in subsequent publications until last month.

The elimination of the issue from Treasury's plans is somewhat surprising. Last year, Risk reported that published guidance was, in fact, "near." The delay had purportedly resulted both from the Treasury's diverted attention to rulings on relief funds for natural disasters, and the loss of several

important Treasury attorneys.

Risk also provided insight as to the likely opinion of the Treasury. In 2006, the contemporary Branch Chief of the IRS Income Tax & Accounting Division said at a Society of Settlement Planners seminar that the single-claimant status of a QSF does not "automatically" trigger economic benefit. Thus, it appeared that the Treasury might soon issue guidance in accord with those favoring single-claimant QSFs.

It is unclear what the removal of the single-claimant QSF issue from the Priority Guidance Plan means. When contacted, Risk responded, "I believe this can be viewed as favorable to plaintiffs seeking to use the QSF, whether or not there is more than one claimant to the assets of the QSF."

Risk believes that the Treasury must have concluded that sufficient guidance on the issue already exists, since § 7805 of the Tax Code provides that "the Secretary shall prescribe all needful rules and regulations for the enforcement of [the Code]." No doubt, the National Structured Settlements Trade Association will interpret the removal of the issue quite differently, so long as its position concerning single-claimant QSFs remains unchanged. Of course, the Treasury may have simply concluded that more issues require resolution than time permits, and found this particular issue to be of less import.

Unfortunately, this leaves plaintiff and defense attorneys, settlement planners and the structured settlement industry without any resolution. While the public policy arguments weigh in favor of single-claimant QSFs, the lack of legal clarity discourages many from making use of the QSF entity in single-claimant cases.

The Priority Guidance Plan is updated throughout the year and responds to suggestions from interested parties, such as tax practitioners and industry groups.

Editor's note: Babener is a third-year student at New York University School of Law, and a notes editor on the *NYU Journal of Law and Business*. He has written two pieces on structured settlements, one published in the *NYU Journal of Law and Business*, the other to be published in the *NYU Journal of Legislation and Public Policy*. He spoke last month at the annual conference of the National Association of Settlement Purchasers on the structured settlement tax subsidy. Portions of this article were used, with permission of the author, by Patrick Hindert on his blog *Beyond Structured Settlements*, <http://s2kmblog.typepad.com>.

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