Forbes

Robert W. Wood
THE TAX LAWYER

TAXES 10/26/2010

What’s A “Structured Settlement”?

Your only exposure to the term "structured settlement" may be late night TV ads hawking immediate access to your money. "It's your money," they'll exhort. "Cash in your structured settlement and use your money now!" If you are (or were) a successful plaintiff in a lawsuit, your contact with structures may be more personal. You may have received one, be evaluating one now, or have considered one but opted for cash.

But what should you know? Even if you already have one, you may not know how they operate and why they're set up in the arcane fashion they are. Like so much else in the world, structured settlements are mostly about taxes.

Cash vs. Periodic Payments. If you're injured in a car accident and receive a $300,000 settlement from the other driver or insurer, it's tax free. See 10 Things To Know About Taxes On Damages. When you invest the $300,000, your investment earnings are taxable. If you receive a structured settlement instead of the $300,000 cash, you'll get payments over a term of years or your lifetime (however you choose), and each payment is fully tax free. Thus, a structure converts your after-tax earnings into a tax free return.

Structured settlement brokers (a special type of insurance agent) consult as a case approaches settlement. For more about brokers, see National Structured Settlements Trade Association. Brokers are paid standardized commissions by the life insurance company that issues the annuity. Brokers can run many financial projections based on a term of years, payments over your life, over your joint life with your spouse, etc. You can even call for no payments for say 10 or 15 years, with payments starting thereafter as a way to fund your retirement.

Thus, structured settlements are very flexible. Provided that you consider these issues ***before*** signing a settlement agreement in your case, you can structure as much or as little as you want and take the rest in cash. With all of this, though, they have to be set up properly.

Mechanics. You can't own the annuity policy or the tax benefits won't work. Rather than paying the cash to you or your lawyer, the defendant will send the money for the structure to a life insurance company's subsidiary called an "assignment company." The assignment company will buy the annuity from its parent life insurance company, and the assignment company will hold the policy and pay you each month as the contract requires.

Special provisions in the tax code allow this arcane structure. Apart from special benefits to insurance companies, the arrangement allows you to be a mere recipient of the periodic payments over time. Even though you're guaranteed to receive each payment, the tax code doesn't treat you as ***owning*** anything except an expectation of each payment.

Structured settlements are tax efficient and can have asset protection and spendthrift advantages too. Like other tax deferral ideas, their results are more impressive the longer their term and the slower they pay out. They aren't for everyone, and you shouldn't structure every nickel you receive. Once they are set up, they generally can't be changed.

Get Your Cash Now! Who are the "cash it in and get your money!" crowd advertising on TV? They are factoring companies. They buy up structures at a discount from accident victims who are receiving structure payments but whose circumstances have changed so they need the cash now. Most states now have a required court hearing before they can buy a structure.

Taxable Structures? Finally, there's another type of structure that has become increasingly popular over the last five years. The same concept is used in non-tax free settlements (like a contract dispute). For more on taxable structures, see:

Structured Settlements Plus Nonqualified Assignments—Expanding the Field of Structures

Structured Settlements and Nonqualified Assignments

For more about structured settlements see:

National Structured Settlements Trade Association

Unqualifying Qualified Structured Settlements?

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.