



**Robert W. Wood**

THE TAX LAWYER

---

February 6, 2026

## How Qualified Settlement Funds For Lawsuits Defer Taxes



When a lawsuit settles, the money can be sent to the plaintiff or his lawyer. Usually it goes to the lawyer, who subtracts legal fees and sends the balance to the client. Alternatively, the funds can be sent to a qualified settlement fund (QSF). QSFs are important dispute resolution vehicles possessing remarkable tax efficiency. They receive special tax treatment so that claimants are not taxed until the QSF distributes funds to them. That helps plaintiffs and their lawyers navigate [settlement tax rules](#).

### History of QSFs

QSFs were meant to help defendants, but they help plaintiffs and lawyers too. QSFs allow plaintiffs time to evaluate structured settlements and to make decisions without involving the defendant. QSFs were put into the tax law in 1993, so that defendants could deduct settlement payments *immediately* upon payment to the QSF, even though it might take years for disputes among plaintiffs and lawyers to be resolved and amounts to be paid out.

### Trust or Segregated Account

Some QSF administrators are trustees and trust companies, while others are bank or escrow companies. IRS regulations state that a QSF can be organized as a trust under state law, *or* that a QSF's assets can otherwise be segregated from the assets of the transferor. The "or" is not accidental.

IRS regulations say that if a QSF "is not a trust under applicable state law, a fund, account, or trust satisfies the requirements [. . .] of this section if its assets are physically segregated from other assets of the transferor." IRS regulations say that a defendant opening a segregated bank account and setting funds aside for settlement satisfies the segregation requirement.

## Administrators Can Be Individuals

The QSF regulations also contain no requirements that a QSF administrator be a professional fiduciary such as a trust company or escrow company. One of the [common myths about QSFs](#) is that the requirements and rules are tough. Yet QSF administrators can be individuals. If a QSF is formed as a trust, the administrator can be the trustee. But for QSFs not formed as trusts, individual administrators may simply be granted signature authority over a bank account opened in the name of the QSF. Under either approach, the assets of the QSF are segregated from the assets of the defendant-transferor.

## Court or Other Governmental Authority

The QSF regulations give claimants and their counsel the flexibility to form a QSF that is tailored to their situation. Many QSFs are approved and supervised by courts. But the tax law does not *require* that a court of law be the governing authority that approves and supervises a QSF. A court of law is not the only permissible government authority. IRS regulations say that a QSF can be approved by and subject to the continuing supervision of any “agency or instrumentality” of the federal government, a state government (including the District of Columbia), or “a political subdivision thereof.”

The supervising governmental authority can be in the executive branch of a government. Examples include the SEC, EPA, a city or county, or many other government agencies. Thus, a valid QSF can be formed as a segregated account that is approved and supervised by a non-court governmental authority, so long as that authority can generally be said to fall within the definition of an agency or instrumentality of a federal, state, county, or local government.

## QSFs Are Flexible

Over the last thirty years, qualified settlement funds have significantly changed the way many lawsuits are brought to conclusion. And many of the objections to QSFs boil down to [myths](#) that can be debunked. The rules can be abused in some circumstances, such as by unduly prolonging the QSF's existence and using it as a long-term tax-deferred pocketbook. But the tax law's requirements for QSFs are flexible, and they can be tailored to individual circumstances. Even a [single-claimant](#) QSF if permitted.

QSFs are not required to be trusts, administrators are not required to be licensed trust companies, and QSFs do not need to be approved by a court of law. [IRS Rules give lawyers considerable leeway](#) and QSFs are more flexible than you may think.