Qualified Settlement Funds: A Primer for Trial Lawyers

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Introduction

Assume you just settled a personal injury case for John Doe who is married to Jane. John has a significant brain injury and there are questions of competency. John was injured on the job but had a products liability claim which is the part of the case you resolved. He receives both Medicaid and Medicare benefits. Medicare and Medicaid both have substantial liens along with the Workers' Compensation carrier. Jane has a consortium claim and there are issues of allocation of the settlement to deal with. A Medicare Set Aside may be necessary and a Special Needs Trust is a must to preserve his Medicaid eligibility. A structured settlement is being considered for part of the settlement proceeds. What do you do when you settle a case like this where a structured settlement is appropriate, your client is on public assistance, there are allocation issues and there are liens to negotiate? Where can you "park" the money while the family determines the appropriate financial plan for the victim, set up any necessary public benefit preservation trusts, determine allocation of the proceeds and negotiate the liens? How can you get the money from the defendant immediately without ruining the client's ability to structure as well as their public assistance eligibility? The answer to all of these questions is to use a Qualified Settlement Fund.

Brief Legislative History

Qualified Settlement Funds grew out of Internal Revenue Code Section 468B. 468B was passed by Congress in 1986 and created Designated Settlement Funds ("DSF"). The DSF was fairly limited in the way it could be utilized and in 1994 the Treasury Department passed regulations creating a new type of fund, Qualified Settlement Funds ("QSF"). The DSF and QSF were created for use in mass tort litigation enabling a defendant to settle a claim by depositing money into a central fund that could then settle with each individual plaintiff. The defendant could walk away from the fund after its creation and funding taking a deduction for the entire settlement amount in the year it was deposited into the fund. However, the QSF is not limited to situations involving mass torts. A Qualified Settlement Fund can be used to settle cases of any value involving multiple plaintiffs including cases involving the personal injury victim with a derivatively injured spouse, child or parent. It can arguably be used in single plaintiff cases based upon the plain language of the Treasury Regulations.

How It Works

Using a 468B Qualified Settlement Fund settlement proceeds can be placed into a QSF trust preserving the right to do a structured settlement and protecting public benefit eligibility temporarily. While the money is in the QSF, a financial settlement plan can be designed and liens can be negotiated. Additionally, if the settlement recipient is on public benefits the QSF avoids issues with constructive receipt of the settlement, which could trigger a loss of public benefits. While the funds are in the QSF, there is time to create a public benefit preservation trust for the settlement recipient. The structured settlement or other financial products can then be set up to work in concert with a special needs trust or Medicare Set Aside so that the injured victim does not lose their public benefits.

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IRS Code § 468B and Income Tax Regulations found at § 1.468B control the use of a QSF. These provisions provide that a defendant can make a qualifying payment to the QSF and economic performance would be accomplished; crucial for tax reasons to the defendant. Thus the QSF trustee can receive settlement proceeds allowing the defendant a current year deduction releasing them from the case. The QSF trustee can, after receiving the settlement proceeds, agree to pay a plaintiff future periodic payments, assign that obligation to a third party, and allow the plaintiff to receive tax-free payments under IRC § 104(a)(2) (the provision excluding from gross income periodic payments from a structure). The transaction works exactly the same as it normally would when you have the defendant involved in the structured settlement transaction.

There are only three requirements under 468B to establish a QSF trust. First, the fund must be established pursuant to an order of a court and is subject to the continuing jurisdiction of the court. Second, it must be established to resolve <u>one or more</u> contested claims arising out of a tort. Third, the fund, account, or trust must be a trust under applicable state law. One restriction is that it can't be used in a Workers' Compensation case.

Mechanically, it is easy to establish a QSF. First, the court having jurisdiction over the litigation must be petitioned to establish the fund. The court is provided with the fund document and an order to establish the fund. Once the order is signed, the defendant is instructed to make a check payable to the QSF and the defendant is given a cash release in return for the payment. The QSF then can fund a structured settlement, pay liens and fund a special needs trust. Once all funds have been distributed, the fund dissolves.

Advantage of QSF

There are several advantages to utilizing a QSF. First, funding the QSF removes the defendant and defense counsel from the settlement process. It is very much like an all cash settlement in the eyes of the defendant. Once the QSF Trustee receives the settlement money, economic performance has occurred and the defendant is out of the case. Second, the attorney's fees and other expenses can be paid immediately from the 468B fund. Third, the 468B trust removes the defendant from the process of allocating the settlement amounts between the various plaintiffs. Fourth, the plaintiffs receive the interest income from the settlement fund. The plaintiffs can take their time, carefully considering the various financial decisions they must make and addressing public benefit preservation issues. Finally and probably most importantly, the time crunch is alleviated with regards to the lien negotiations, allocations, and probate proceedings.

Conclusion

The end of a personal injury case is typically one big time crunch which I call the "settlement time crunch". There is enormous pressure to wrap up the case quickly to get the client paid and you paid. However, in the rush to finalize the settlement you may overlook or miss important settlement planning issues. Instead, a Qualified Settlement Fund can be created to receive the settlement proceeds thereby giving everyone the time necessary to carefully plan for the future. You can get your fees and costs quickly. The funds are obtained from the defendant, they are released and the client's settlement dollars can begin to earn interest. The liens can be negotiated, allocation decisions can be made, public benefit preservation trusts can be implemented and structured settlements can be considered. Your option to structure your

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attorney fees is also preserved. The QSF is an important tool for trial lawyers to consider using. With all of the advantages a QSF offers why wouldn't you utilize one when you settle a case?

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