



## Tax Controversy Surrounds Plaintiff Payment Plans

### Pitfalls abound in using qualified settlement funds in personal injury cases

By MARTIN JACOBSON

Structured settlement payments to plaintiffs in cases involving physical injury, physical sickness, or wrongful death have been excluded from income for federal (and state) tax purposes since Congress enacted the Periodic Payment Settlement Act of 1982. Prior to that act, the tax treatment of structured settlement payments was governed by Revenue Ruling 79-220.

In 1986, Congress enacted Internal Revenue Code Section 468B to allow defendants in multiple plaintiff cases to enter into global settlements and extinguish defendants liability to all plaintiffs, notwithstanding the fact that none of the individual plaintiffs yet knew the precise amount of money (from the global settlement) that he or she was going to receive in settlement of his or her individual claim.

Treasury Reg. 1-468B-1 *et seq.* issued in 1992 offered guidance to the bar on the use of IRC 468B when settling cases. Treasury Reg. 1.468B-1 (2) provides that a qualified settlement fund may be established to resolve or satisfy one or more contested or uncontested claims that have resulted . . . from an event . . . that has given rise to at least one claim asserting liability . . .

In 1993, Revenue Procedure 93-34 was issued by the IRS to provide rules governing the use of qualified assignments in cases where defendants money has been placed into a qualified settlement fund pursuant to

court order settling a personal injury lawsuit. Language similar to the phrase found in the Treasury regulation quoted above appears in Revenue Procedure 93-34. In subsection (2), reference is made to the [qualified] assignment [being] made with respect to a claim on account of personal injury or sickness . . . Later, in subsection (3) this same Revenue Procedure provides that each qualified funding asset purchased by the assignee . . . relates to a liability to a single claimant to make periodic payments for damages . . .

The use of the phrase "one or more contested or uncontested claims" in the Treasury regulation quoted above, combined with the reference to a claim in the Revenue Procedure, has led to a tax controversy not yet resolved, and the need for caution by the bench and bar in resolving individual personal injury claims with a court ordered qualified settlement fund under Internal Revenue Code Section 468B. [The Revenue Procedure 93-34 (3) requirement that each qualified funding asset purchased by the assignee . . . relates to a liability to a single claimant to make periodic payments for damages . . . has always been the law with respect to every structured settlement. Even if there were 100 claimants, each claimants structured settlement would have to be funded with qualified funding assets specific to each claimants future periodic payments. See Internal Revenue Code Section 130 (d) generally, and 130(d)(2) in particular.]

#### The Risk

Like many things in life that sound too good to be true, so too may be this. If the plaintiff is ever audited by the Internal Rev-

enue Service and loses the tax-free advantages of a proper structured settlement, the plaintiff will owe back taxes, interest and penalties.

The now failed structured settlement would be treated in exactly the same way as an ordinary (tax-deferred, but not tax-free) annuity purchased by a plaintiff who settled for cash. In even a moderate size case, the back taxes, interest and penalties (to say nothing of the cost of defending the audit) would threaten to wipe out the settlement.

I leave the discussion of potential legal malpractice claims to another time.

#### Constructive Receipt

First, there is no question that IRC 468B may be used in single plaintiff cases. Consequently, the use of the term "one or more contested or uncontested claims" in the Treasury regulation quoted above begs the question. Yes, a court-approved qualified settlement fund may be properly established in a single claimant personal injury lawsuit. However, the real question is whether a single-plaintiff qualified settlement fund may enter into a structured settlement with the plaintiff and execute a qualified assignment under Internal Revenue Code section 130 (c).

For purposes of this article, suffice it to say that a qualified settlement fund acting as an assignor under code section 130(c) may have rights equal to, but no greater than, the original defendant. In other words, if the defendant cannot execute a qualified assignment under code section 130(c), then neither may the qualified settlement fund.

In 1983, the IRS was asked whether knowledge of the cost of a structured settle-

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