

# STRUCTURED SETTLEMENTS AND SINGLE-CLAIMANT QUALIFIED SETTLEMENT FUNDS: REGULATING IN ACCORDANCE WITH STRUCTURED SETTLEMENT HISTORY

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## INTRODUCTION

In 1982, Congress created a subsidy for a relatively new type of settlement: the structured settlement. Rather than paying plaintiff<sup>1</sup> with a single check of \$1 million, defendant pays plaintiff \$2 million in increments over the next twenty years. As Congress would later

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1. Because some personal injury settlements are made before a law suit is filed, the terms "plaintiffs" and "claimants" will be used interchangeably in this Article. Because the cost of settling is typically borne by a defendant's liability insurance carrier, Barbara D. Goldberg & Kenneth Mauro, *Utilizing Structured Settlements, in EVALUATING & SETTLING A PERSONAL INJURY CASE: PLAINTIFFS' AND DEFENDANTS' PERSPECTIVES* 31, 35-36 (Practising Law Institute, 2001), the term "defendants" and "liability insurers" will be used interchangeably, unless distinguishing is necessary for a particular topic.

explain, spreading the receipt over a long period of time serves the public interest by preventing a plaintiff from prematurely dissipating that money,<sup>2</sup> and possibly becoming dependent upon the state. Thus, it extended the income tax exclusion of personal injury settlement monies to periodic payments, creating the structured settlement tax subsidy.

In so doing, Congress emphasized the application of two well-established tax doctrines that would withhold tax subsidy eligibility if violated: constructive receipt and economic benefit. Congress made clear that a personal injury plaintiff who obtained such control over their settlement funds would not receive the subsidy's benefit. Thus, Congress established a monetary incentive to sacrifice control and immediate receipt of one's settlement monies.

While the legislation immediately began increasing the use of structured settlements, it became clear, at least early on, that defendants were capturing much of the benefit by the conclusion of settlement negotiations. Though this usurpation may have lessened over time as plaintiff advisors became more knowledgeable about structured settlements, it continues today. During the last decade, plaintiffs have used a new entity to capture more of that benefit: the qualified settlement fund.<sup>3</sup> Plaintiffs agree with defendants on a lump-sum settlement amount, and direct that amount to a qualified settlement fund. Thereafter, plaintiffs can structure a settlement to maximize its benefits, without the conflicting objectives inherent in plaintiff-defendant negotiations. Such a fund can be used over the objection or even without the knowledge of defendants.

Because the use of this fund by single-claimants may break two important tax rules that Congress originally applied to the structured settlement tax subsidy—the constructive receipt<sup>4</sup> and economic bene-

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2. Anecdotal evidence suggests that the vast majority of lump-sum settlement recipients prematurely dissipate their settlement moneys. However, though many have cited to the statistic that 90% of such recipients prematurely dissipate their monies within five years, the statistic has been found to be unsubstantiated. Jeremy N. Babener, Note, *Justifying the Structured Settlement Tax Subsidy: The Use of Lump Sum Settlement Monies*, 6 N.Y.U. J. L. & Bus. 127 (2009); see Laura J. Koenig, *Lies, Damned Lies, and Statistics? Structured Settlements, Factoring, and the Federal Government*, 82 IND. L. J. 809, 810 (2007); Adam F. Scales, *Against Settlement Factoring? The Market in Tort Claims Has Arrived*, 2002 WIS. L. REV. 859, 870, 873 (2002).

3. See Part V.B.

4. A taxpayer acquires constructive receipt of monies, though not actually in the taxpayer's possession, once the monies have been set aside for his or her exclusive use and can be drawn upon at any time. Treas. Reg. § 1.451-2(a) (as amended in 1979); see *infra* note 80.

fit doctrines<sup>5</sup>—it is unclear if such claimants can make use of qualified settlement funds and still access the subsidy. Thus, qualified settlement funds have not been widely used because plaintiffs and their advisors do not want to risk the loss of the structured settlement tax subsidy.

Treasury regulations<sup>6</sup> could cure the ambiguity, but should do so in accordance with structured settlement history, and in the interest of public policy. Letters to the Treasury have been written for and against the approval of single-claimant qualified settlement funds being eligible for the 1982 tax subsidy when establishing structured settlements. At least one law review article has also been written in favor of single-claimant qualified settlement funds.<sup>7</sup> Building on prior work, this Article will demonstrate how Treasury regulations extending structured settlement tax subsidy eligibility to structured settlements produced by single-claimant qualified settlement funds would, if found to violate tax doctrine, only constitute a further step in

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5. A taxpayer acquires the economic benefit of monies when they are unconditionally and irrevocably transferred to him or her, though not necessarily accessible. For example, an employee acquires the economic benefit of an irrevocable contribution to a deferred compensation plan where the plan is vested in the employee and secured against the employer's creditors. *See* *Minor v. United States*, 772 F.2d 1472, 1474 (9th Cir. 1985) (citing Rev. Rul. 60-31, 1960-1 C.B. 174, 179); *infra* note 81 (discussing the well-known *Sproull v. Comm'r* decision). The doctrine has been called "a limited, technical device, created and advanced by the government in order to collect taxes from cash basis taxpayers as soon as possible." *Thomas v. United States*, 45 F. Supp. 2d 618, 625 (S.D. Ohio 1999). That court established three elements that, together, trigger economic benefit:

- (1) There must be some fund in which money or property has been placed;
- (2) The fund must be irrevocable and beyond the reach of the creditors of the party who transferred the funds to the escrow or trust; and
- (3) The beneficiary must have vested rights to the money, with receipt conditioned only on the passage of time.

*Id.* at 620 (1999) (citing *Sproull v. Comm'r*, 16 T.C. 244 (1951), *aff'd*, 194 F.2d 541 (6th Cir. 1952)). The Court stated that a beneficiary's interest in a fund is "'vested' if it is nonforfeitable." *Id.* at 621 (citing I.R.S. Gen. Couns. Mem. 33,733 (Nov. 21, 1966)).

6. The Secretary of the Treasury, empowered to "prescribe all needful rules and regulations for the enforcement of [the Tax Code]," I.R.C. § 7805(a) (2006), has "delegated much of this rulemaking authority to the I.R.S. Chief Counsel's Office." LEANDRA LEDERMAN & STEPHEN W. MAZZA, *TAX CONTROVERSIES: PRACTICE AND PROCEDURE* 31 (3d ed. 2009). Thus, while the Treasury Department remains the official source of such regulations, *id.*, this Article alternatively calls for new regulations from the Treasury and the Internal Revenue Service (IRS). Of course, Congress could also act to achieve the same result.

7. Richard B. Risk, Jr., *A Case for the Urgent Need to Clarify Tax Treatment of a Qualified Settlement Fund Created for a Single Claimant*, 23 VA. TAX REV. 639 (2004) [hereinafter Risk, *A Case*].

an ongoing deconstruction of the constructive receipt and economic benefit doctrines, performed through legislative, administrative, and regulatory action. Moreover, the degradation of these doctrines, at least in the context of single-claimant qualified settlement funds, would serve to fulfill the purpose of the original 1982 legislation, despite the apparent inconsistency. Thus, this Article recommends the issuance of Treasury regulations extending structured settlement tax subsidy eligibility to structured settlements produced by single-claimant qualified settlement funds.

Part I introduces the reader to the use and popularity of structured settlements, explaining how the tax subsidy increases the value of a structured settlement. Part II details the early history of structured settlements, including the 1979 Internal Revenue Service (IRS) rulings and 1982 legislation establishing the tax subsidy. It highlights both the application of the economic benefit and constructive receipt doctrines, as well as the purpose of the 1982 legislation: preventing premature lump-sum dissipation. Part III narrates the subsequent erosion of the constructive receipt and economic benefit doctrines. It details the birth and later implicit approval of “factoring,” the selling of structured settlements by former claimants. This section suggests that the erosion of the two doctrines may in fact serve the purpose of the original 1982 legislation. Part IV demonstrates the need for the use of single-claimant funds by elaborating on the methods defendants and their liability insurers have used to minimize settlement costs. This section argues that it is in the interest of public policy to direct the benefits of structuring a settlement away from defendants, and toward plaintiffs, so long as structured settlements are not discouraged. Part V describes how single-claimant qualified settlement funds can be used to capture increased benefits for plaintiff, and argues that the continued erosion of the economic benefit doctrine in relation to structured settlements is consistent with past erosion, and serves the purpose of the original 1982 legislation creating the tax subsidy.

## I.

## WHAT IS A STRUCTURED SETTLEMENT?

A. *A Popular Tool*

As early as 1981, structured settlements<sup>8</sup> were being hailed as “the wave of the future.”<sup>9</sup> Predictions were made that “social and professional pressure”<sup>10</sup> would require the consideration of structured settlements in negotiations.<sup>11</sup> These predictions were proven out.<sup>12</sup>

By all accounts, structured settlements are being used with great frequency. In a large study of over 1,750 commercial liability bodily injury claims, 12% resulted in structured settlements.<sup>13</sup> Approximately one-third of injured victims offered a structured settlement agree to it.<sup>14</sup> Together, these two pieces of information suggest that

8. The Tax Code defines a structured settlement as an arrangement established by (i) suit or agreement for the periodic payment of damages excludable from the gross income of the recipient under section 104(a)(2), or (ii) [an] agreement for the periodic payment of compensation under any workers’ compensation law excludable from the gross income of the recipient under section 104(a)(1) . . . [where periodic payments are] (i) of the character described in subparagraphs (A) and (B) of section 130(c)(2), and (ii) payable by a person who is a party to the suit or agreement or to the workers’ compensation claim or by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with section 130.

I.R.C. § 5891 (2006) (defining the term for purposes of section 5891). Section 130(c)(2) provides, “(A) such periodic payments are fixed and determinable as to amount and time of payment, (B) such periodic payments cannot be accelerated, deferred, increased, or decreased by the recipient of such payments.” I.R.C. § 130(c)(2)(A)–(B) (2006).

9. Howard Rudnitsky & Jeff Blyskal, *Something for Everyone*, FORBES, 29, 29 (Jan. 19, 1981) (quoting attorney Fred Levin upon agreeing to a structured settlement worth over \$10 million).

10. *Structuring Settlements: A Roundtable*, 19 TRIAL 70, 80 (Jan. 1983) [hereinafter *A Roundtable*] (comments of Lawrence Charfoos).

11. *Id.* By 1983, commentators were projecting that plaintiff attorneys might soon face malpractice suits for not informing their clients of the option. *Id.* at 79 (comments of Herb Cumming); see also Amy J. Conner, *Is Plaintiffs’ Lawyer Liable for Not Offering Structured Settlement?*, LAW. WKLY. USA, Aug. 6, 2001, at 1, available at [http://www.jmwsettlements.com/structured\\_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf](http://www.jmwsettlements.com/structured_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf).

12. Christopher R. Gullen, *What Attorneys Need to Learn From Grillo v. Pettietie*, MICH. B. J., Aug. 2003, at 28 (discussing a legal malpractice settlement for more than \$4 million resulting from a former personal injury plaintiff suing the attorney and guardian ad litem, both of whom recommended the acceptance of a cash settlement).

13. INSURANCE SERVICES OFFICE, INC., CLOSED CLAIM SURVEY FOR COMMERCIAL GENERAL LIABILITY: SURVEY RESULTS, 1997, 22 (1997) [hereinafter ISO SURVEY] (finding that nearly 25% of the claims where claimants received over \$300,000 involved structured settlements).

14. *Tax Treatment of Structured Settlements: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 106th Cong. 38 (1999) (statement of

more than a third of personal injury claimants are offered a structured settlement. So much use amounts to over \$6 billion of structured settlement premiums being purchased each year,<sup>15</sup> an estimated 5% of the \$130 billion of total annual personal injury settlements.<sup>16</sup> Even the 2008 financial crisis does not appear to have significantly harmed the structured settlement industry.<sup>17</sup> Because structured settlements have been available for over three decades, there are currently two million Americans holding some \$100 billion in structured settlements.<sup>18</sup>

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Thomas W. Little, Former President of National Structured Settlements Trade Association, on behalf of the NSSTA); Letter from Malcolm Deener, President, NSSTA, to Gregory F. Jenner, Acting Assistant Secretary for Tax Policy, Department of the Treasury, and Donald L. Korb, Chief Counsel, I.R.S. (May 10, 2004), *available at* <http://www.risklawfirm.com/files/DeweyBallentineIrttoSenBaucus06-29-04.pdf> [hereinafter NSSTA Letter].

15. Risk, *A Case*, *supra* note 7, at 644 n.13 (citing Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003)); *cf.* Scales, *supra* note 2, at 882 n.72 (citing Press Release, National Structured Settlements Trade Ass'n, Structured Settlements Industry Reports 19 Percent Surge in Demand During 2001; \$6.05B Is Best Year in History (Feb. 5, 2002)). In the past, some have estimated the value to reach some \$10 billion, *Tax Treatment of Structured Settlements: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways and Means*, 106th Cong. 78 (1999) [hereinafter *1999 Hearing*] (written statement of J.G. Wentworth, a finance company that purchases and securitizes structured settlements), or even \$12 billion. Anthony Riccardi & Thomas Ireland, *A Primer on Annuity Contracts, Structured Settlements, and Periodic-Payment Judgments*, 12 J. LEGAL ECON. 1, 8 (2002–2003) (citing <http://www.nssta.com>).

16. See Christopher Sheffield, *Evolve Financial Division Ramps Up Marketing to Grow Settlement Business*, MEMPHIS BUS. J., Feb. 1, 2008, *available at* <http://birmingham.bizjournals.com/memphis/stories/2008/02/04/story11.html>. The study by Towers Perrin reported total tort costs in the United States of \$252 billion in 2007. TOWERS PERRIN, 2008 UPDATE OF U.S. TORT COST TRENDS 3, *available at* [http://www.towersperrin.com/tp/getwebcachedoc?webc=USA/2008/200811/2008\\_tort\\_costs\\_trends.pdf](http://www.towersperrin.com/tp/getwebcachedoc?webc=USA/2008/200811/2008_tort_costs_trends.pdf). The total incorporates the benefits paid or expected to be paid to third parties, defense costs, and administrative expenses. *Id.* at 8. Patrick J. Hindert, author of STRUCTURED SETTLEMENTS AND PERIODIC PAYMENTS, suggests that payments to injury victims and their attorneys reached \$161 billion in 2006, based on one of the Towers Perrin study principals. Patrick J. Hindert, *Structured Settlement Surveys*, BEYOND STRUCTURED SETTLEMENTS, Nov. 23, 2008, [http://s2kmblog.typepad.com/rethinking\\_structured\\_set/2008/11/structured-settlement-surveys.html](http://s2kmblog.typepad.com/rethinking_structured_set/2008/11/structured-settlement-surveys.html).

17. Some in the industry believe that the current economic uncertainty and declining investment performance drives more people to consider structured settlements. Telephone Interview with Betty Gregware, Sales Executive, John Hancock Life Insurance Co. (Feb. 29, 2009) [hereinafter Gregware Interview]; E-mail from John McCulloch, Vice President National Marketing Director, EPS Settlement Group, Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 9, 2009, 8:30:59 EST) (on file with author) [hereinafter McCulloch E-mail] (predicting increased use of structured settlements as a result of a “flight to quality”).

18. See Press Release, J.G. Wentworth, The #1 Reason Consumers Sell Their Structured Settlements Is to Pay Bills, According to Survey by J.G. Wentworth (Nov.

Unsurprisingly, an industry has spawned and expanded to meet and drive demand. As of 2000, there were approximately 430 full-time structured settlement brokers.<sup>19</sup> As of 2001, more than two dozen insurance companies were selling structured settlement annuities.<sup>20</sup>

Early on, structured settlements faced opposition within the plaintiff attorney field.<sup>21</sup> By 1983, however, some plaintiff attorneys were already initiating structured settlement discussions of their own accord.<sup>22</sup> Currently, they are applauded by plaintiffs, defendants, and brokers alike.<sup>23</sup> The National Structured Settlements Trade Association (NSSTA) can point to many supporters of structured settlements.<sup>24</sup> For example, Andrew J. Imparato, the President of the American Association of People with Disabilities, said, “[s]tructured settlements are a model benefit for people with disabilities.”<sup>25</sup>

Because the tax exemption favors the plaintiff, defendant, and broker,<sup>26</sup> the exemption rarely faces serious scrutiny. Perhaps the most thorough examination, aside from a rare few academic articles, was provided by a sister industry spawned in the 1990s.<sup>27</sup> The “factoring”<sup>28</sup> industry, populated by companies who purchase the future stream of income of a structured settlement annuity *from* former claimants, was strongly criticized by the structured settlement selling

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4, 2008), available at <http://www.jgwentworth.com/About/News/Press/Detail.aspx?i=46> [hereinafter The #1 Reason].

19. Richard B. Risk, Jr., *Structured Settlements: The Ongoing Evolution From a Liability Insurer's Ploy to an Injury Victim's Boon*, 36 TULSA L.J. 865, 879 (2001) [hereinafter Risk, *Structured Settlements*].

20. *Id.* at 878.

21. Vasilios B. Choulos, *Structured Settlements: Cure or Curse?*, 16 TRIAL 73, 74 (Nov. 1980).

22. *A Roundtable*, *supra* note 10, at 72 (comments of Herb Cumming).

23. *See* Scales, *supra* note 2, at 887.

24. National Structured Settlements Trade Association, Independent Voices, <http://www.nsstata.com/i4a/pages/index.cfm?pageid=3291> (last visited Jan. 20, 2009).

25. *Id.* (quoting Andrew J. Imparato, President, American Association of People with Disabilities).

26. Scales, *supra* note 2, at 887.

27. Margaret Mannix, *Settling for Less: Should Accident Victims Sell Their Monthly Payouts?*, U.S. NEWS & WORLD REP., Jan. 25, 1999, at 62; Vanessa O'Connell, *Like It Or Lump It: Thriving Industry Buys Insurance From Injured Plaintiffs*, WALL ST. J., Feb. 25, 1998, at A1.

28. The term “factoring” was once used as a derogatory term by insurance companies; however, since incorporation into federal law, I.R.C. § 5891 (2006), the term has been increasingly used by purchasing company insiders. Telephone Interview with Matt Bracy, General Counsel, Settlement Capital Corp. (Mar. 12, 2009) [hereinafter Bracy Interview].

industry in the mid and late 1990s.<sup>29</sup> Much of the negative criticism of the structured settlement industry was made during this time.<sup>30</sup>

### B. *The Typical Structured Settlement*

The typical structured settlement is agreed to after a lawsuit has been filed,<sup>31</sup> but before substantial involvement by a judge.<sup>32</sup> Structured settlements vary in value. One large survey found that two-thirds of claims using structured settlements involved “major injuries,” averaging a total payout of \$408,000.<sup>33</sup> The other one-third percent averaged a total payout of \$210,000.<sup>34</sup> However, testimony on behalf of the factoring industry represented that more than half of structured settlement premiums fall below \$50,000, and that less than 13% exceed \$250,000.<sup>35</sup> In any case, some practitioners suggest that a structured settlement can be created for \$10,000 or \$20,000,<sup>36</sup> though values as low as \$5,000 and \$2,700 have been reported.<sup>37</sup> The average stream of periodic payments guaranteed by a structured settlement is for twenty years.<sup>38</sup> However, structured settlements commonly include life-contingent payments as a component.<sup>39</sup>

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29. Risk, *Structured Settlements*, *supra* note 19, at 883.

30. *See infra* Part III.

31. Telephone Interview with Jack L. Meligan, Plaintiff Loyal Settlement Planner, Settlement Professionals Inc. (Feb. 5, 2009) [hereinafter Meligan Interview].

32. E-mail from William L. Neff, Partner, Hogan & Hartson LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 23, 2009, 19:29:04 EST) (on file with author) [hereinafter Neff E-mail, Feb. 23, 2009].

33. ISO SURVEY, *supra* note 13, at 22.

34. *Id.*

35. 1999 *Hearing*, *supra* note 15, at 17 (statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

36. Leo Andrada, *Structured Settlements: The Assignability Problem*, 9 S. CAL. INTERDIS. L.J. 465, 468, 472 (2000). Life insurance companies set minimum annuity values. McCulloch E-mail, *supra* note 17. For example, John Hancock Life has a policy minimum of \$10,000. Gregware Interview, *supra* note 17.

37. Meligan Interview, *supra* note 31. Meligan cites the \$2,700 structured settlement as a one-time occurrence, and \$5,000 structured settlements as rare, occurring at his office perhaps once per year. *Id.* Structured settlements for \$20,000 are seen more regularly. *Id.*

38. 1999 *Hearing*, *supra* note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

39. E-mail from Craig H. Ulman, Counsel to NSSTA to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 16, 2009, 16:06:14 EST) (on file with author) [hereinafter Ulman E-mail, Feb. 16, 2009]. Life contingent payments are periodic payments made to a beneficiary until their death. *See generally* BLACK'S LAW DICTIONARY (West 8th ed. 2004) (defining “annuity”).

Not all of a defendant's payment<sup>40</sup> is typically used to purchase an annuity.<sup>41</sup> On average, half of the payout is transferred as an upfront lump-sum to plaintiff, while the other half is paid through the purchase of an annuity<sup>42</sup> via a structured settlement company.<sup>43</sup> From the latter purchase, a structured settlement broker will typically receive a commission of between 2%<sup>44</sup> and 4%.<sup>45</sup>

Anti-assignment clauses, stipulations in the contract preventing plaintiff from transferring rights to the future stream of income, have often been included in settlement agreements.<sup>46</sup> However, these are not necessarily followed,<sup>47</sup> and some courts choose not to enforce them.<sup>48</sup> The practice of "factoring," selling one's right to receive fu-

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40. The cost of the structured settlement is typically borne by a defendant's liability insurance carrier. Goldberg & Mauro, *supra* note 1, at 35–36.

41. See Thomas C. Downs, *Superfund Colloquium: Periodic Payment of Claims: New Hope for CERCLA Settlements?*, 8 TUL. ENVTL. L.J. 387 (1995).

42. ISO SURVEY, *supra* note 13, at 22; Gregware Interview, *supra* note 17 (making a back-of-the-envelope estimation that, of those settlements with structured components, perhaps 40% to 50% of the total settlement is structured). Structured settlement companies are often subsidiaries of insurance companies. See Dan Luther, *Trusts May be Superior to 'Structured Settlements'*, 129 TRUSTS & ESTATES, 28, 28 (Dec. 1990).

43. As will be seen in the next section, *infra* Part I.C., the structured settlement company assumes the defendant's liability through novation, and purchases an annuity to make periodic payments to the claimant from a life insurance company. Thus, the structured settlement company can also be referred to as an assignee, having been assigned liability from the defendant. This Article will refer to such a company as a "structured settlement company."

44. Risk, *Structured Settlements*, *supra* note 19, at 890.

45. Robert W. Wood, *Single-Claimant Qualified (468B) Settlement Funds?*, TAX NOTES, Jan. 5, 2009, at 71, 73 [hereinafter Wood, TAX NOTES] (noting that the commission will be paid for by the life insurance company); *1999 Hearing*, *supra* note 15, at 19 (1999) (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers). The standard commission is 4%. E-mail from Patrick J. Hindert, Managing Director, S2KM Ltd. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Sept. 4, 2009, 12:00:15 EDT) (on file with author) [hereinafter Hindert E-mail, Sept. 4, 2009]. However, multiple agents frequently share the 4%, thus reducing any individual agent's take. *Id.* One commentator notes that such commission sharing can create a conflict of interest, sometimes not disclosed to the structured settlement recipient. *Id.*

46. Scales, *supra* note 2, at 902.

47. See *Settlement Funding, LLC v. Jamestown Life Ins. Co.*, 78 F. Supp. 2d 1349, 1364 (N.D. Ga. 1999) (noting that the court was "not convinced that there exists a public policy against the assignability of structured payments to protect the recipients of the payments 'from squandering their benefits'"). *But see* *C.U. Annuity Service Corp. v. Scott Young*, 722 N.Y.S.2d 236 (N.Y. App. Div. 2001); *Green v. Safeco Life Ins.*, 727 N.E.2d 393 (Ill. App. Ct. 2000); *Liberty Life Assur. Co. of Boston v. Stone Street Capital, Inc.*, 93 F. Supp. 2d 630 (D. Md. 2000); *Singer Asset Finance Co. v. Bachus*, 741 N.Y.S.2d 618 (N.Y. App. Div. 2002).

48. *Settlement Funding, LLC*, 78 F. Supp. 2d at 1364.

ture structured settlement payments, is a common transaction that will be discussed later in Part III. Factoring transactions, and legislative decisions regarding them, have done much to erode the tax doctrines discussed in this Article, as applied to structured settlements.

### C. A Tax Subsidy at Work

Structured settlements for personal injury claims are made between parties as an alternative to a lump-sum payment.<sup>49</sup> Rather than a defendant writing plaintiff a check for \$1 million, for example, the defendant could agree to pay plaintiff \$2 million in installments on a semi-annual or monthly basis over a period of years. Because the defendant possesses the bulk of the amount for those years, and can invest it, more money can be paid out later on. Business defendants incapable of making an immediate high-value payment are also able to keep their doors open by delaying payment. Thus, the configuration of a structured settlement is inherently attractive to certain parties, in certain situations.<sup>50</sup>

However, the tax treatment of the structured settlement renders the arrangement even more attractive, and to both sides.<sup>51</sup> It is said that the \$6 billion market for structured settlement annuities “owes its existence almost entirely”<sup>52</sup> to what the Joint Committee on Taxation calls a “tax subsidy.”<sup>53</sup> The tax subsidy does this by extending the Tax Code’s favored treatment of lump-sum awards and settlements for physical injuries to periodic payments. It has long been true that

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49. Other alternatives, like trusts, exist. *See generally* Luther, *supra* note 42.

50. NSSTA can produce countless supporters of the tax subsidy, National Structured Settlements Trade Association, Independent Voices, <http://www.nssta.com/i4a/pages/index.cfm?pageid=3291> (last visited Feb. 2, 2009), and many articles have been written listing the advantages. *E.g.*, Dirk Yandell, *Advantages and Disadvantages of Structured Settlements*, 5 J. LEGAL ECON. 71 (1995).

51. Goldberg & Mauro, *supra* note 1, at 68; *A Roundtable*, *supra* note 10, at 70 (comments of Lawrence Charfoos).

52. Scales, *supra* note 2, at 895 (citing *A Roundtable*, *supra* note 10, at 72 (comments of Charles Krause); *1999 Hearing*, *supra* note 15, at 32–33 (Statement of Timothy J. Trankina, Peachtree Settlement Funding)).

53. JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999); *see* Meligan Interview, *supra* note 31 (stating that many fewer structured settlements would occur without the tax exemption); Telephone Interview with Randy Dyer, Former Executive Vice President, NSSTA (Feb. 18, 2009) [hereinafter Dyer Interview] (stating that without the tax exemption, structured settlements would be much less common). *But see* McCulloch E-mail, *supra* note 17 (arguing that the long term security and flexibility of structured settlements are stronger reasons for a plaintiff to structure than the tax benefit); Ulman E-mail, Feb. 16, 2009, *supra* note 39 (noting that additional benefits such as protection against creditor claims and mortality risk might sometimes be more important to claimants).

plaintiffs do not include physical injury awards or settlement monies in gross income for purposes of taxation.<sup>54</sup> Once the plaintiff receives those monies and invests them, however, the gain derived is not exempted from taxation.<sup>55</sup>

However, IRS revenue rulings in the late 1970s, and Congress's enactment of the Periodic Payment Settlement Tax Act of 1982, approved a tax exemption that would allow personal injury money to be invested without incurring taxable earnings. In the 1982 Act, Congress amended section 104(a)(2) of the Tax Code to exclude personal physical injury and sickness damages "whether as lump-sums or as *periodic payments*."<sup>56</sup> Thus, plaintiffs could receive damages in installment payments, without losing the beneficial tax-exempt status of award or settlement monies.<sup>57</sup>

At the same time, Congress also established section 130, which operated on the defense side corresponding to section 104(a)(2)'s amendment affecting the plaintiff side. Section 130 exempts income

54. T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918).

55. See Rev. Rul. 79-313, 1979-2 C.B. 75 (citing Rev. Rul. 65-29, 1965-1 C.B. 59); Andrada, *supra* note 36, at 470 (citing *Kovacs v. Comm'r*, 100 T.C. 124 (1993), *aff'd per curiam*, 25 F.3d 1048 (6th Cir. 1994), *cert. denied*, 513 U.S. 963 (1994)); Goldberg & Mauro, *supra* note 1, at 38; Lawrence A. Frolik, *The Convergence of I.R.C. § 104(a)(2)*, *Norfolk & Western Railway Co. v. Liepelt and Structured Settlements: Tax Policy 'Derailed'*, 51 *FORDHAM L. REV.* 565, 566 (1983). *But see* I.R.C. § 103 (2006) (exempting interest on state and local bonds from gross income). Earnings on the award or settlement are taxed regardless of whether the parties calculated the lump-sum value based upon future investment. Frolik, *supra*, at 575.

56. I.R.C. § 104(a)(2) (2006) (emphasis added) (excluding "the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness"). Treasury regulations define "damages received whether by suit or agreement" to include amounts received, except for workmen's compensation, "through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution." Treas. Reg. § 1.104-1(c) (as amended in 1970). Considerable literature is dedicated to differentiating those types of injury payments that do and do not constitute physical injuries or physical sickness. *E.g.*, Henry E. Smith, Symposium, *Liability for Inchoate and Future Loss*, 88 *Va. L. Rev.* 1953 (2002).

57. The exemption for these payments continues even upon plaintiff's death. Goldberg & Mauro, *supra* note 1, at 38 (citing Rev. Rul. 79-220, 1979-2 C.B. 74). States also hold lump sums and periodic payments to be tax exempt. National Structured Settlements Association, *Structured Settlements: Financial Protection During Economic Crisis*, Jan. 23, 2009, [http://www.nssta.com/files/public/FINANCIAL\\_SECURITY\\_HAND-OUT\\_10-08.pdf](http://www.nssta.com/files/public/FINANCIAL_SECURITY_HAND-OUT_10-08.pdf). The exclusion affects state income taxes as well as federal. Many states use the federal definition of taxable income for their taxable base. *E.g.*, CAL. REV. & TAX CODE § 17071 (West 2009). At least one state explicitly excludes compensation for personal injuries and sickness. Some states continue to exclude non-physical injuries and sickness. N.J. STAT. ANN. § 54A:6-6 (West 2009).

paid by defendants to structured settlement companies for taking on defendants' liability to make future payments to plaintiff through a "qualified assignment."<sup>58</sup> The income is exempt from tax "to the extent that such amount does not exceed the aggregate cost of any qualified funding assets,"<sup>59</sup> those assets being the annuity purchased to fund plaintiff's future payments.

Thus, a transfer of liability would follow these steps. First a defendant might pay \$100,000 to a structured settlement company in consideration for the company assuming liability for plaintiff's future payments. The company pockets \$3,000 as a fee, and purchases a \$97,000 annuity. Because of section 130, the structured settlement company need only pay income tax on the \$3,000 fee.<sup>60</sup>

The benefit to the defendant can be seen in the subsequent step. Defendant businesses can deduct personal injury damages paid as a business expense.<sup>61</sup> Thus, the lump-sum payment defendant makes to a structured settlement company will be immediately deductible.<sup>62</sup> That sum acts as an investment principal, which produces earnings over the future payout period. Neither the defendant, nor the structured settlement company, nor the plaintiff, will ever pay taxes on those earnings.<sup>63</sup> In this way, section 104(a)(2) and section 130 combine to create an incredibly beneficial settlement arrangement option

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58. See I.R.C. § 130(a) (2006). A qualified assignment is defined as "any assignment of a liability to make periodic payments as damages . . . [where] such periodic payments are fixed and determinable as to amount and time of payment . . . [and] cannot be accelerated, deferred, increased, or decreased by the recipient of such payments." I.R.C. § 130(c) (2006).

59. See I.R.C. § 130(a) (2006). A qualified funding asset has many requirements, including three particularly substantive ones. First, the investment must be an "annuity contract issued by a . . . licensed . . . insurance company . . . or any obligation of the United States." I.R.C. § 130(d) (2006). Second, the timing and amounts of periodic payments must be "reasonably related," to the timing and amounts of payments owed to the plaintiff. *Id.*; Andrada, *supra* note 36, at 483 (citing I.R.C. § 130(d)). And third, the annuity must be purchased within sixty days of the qualified assignment. I.R.C. § 130(d)(4) (2006).

60. See Andrada, *supra* note 36. See generally I.R.C. § 130 (2006).

61. See Joseph W. Blackburn, *Taxation of Personal Injury Damages: Recommendations for Reform*, 56 TENN. L. REV. 661, 687 (1989) (citing I.R.C. § 165(a) (1986)); I.R.C. § 162 (2006 & Supp. II 2008).

62. See Andrada, *supra* note 36, at 482, n.59, 483. The defendant can only deduct the present value of the future stream of income, and not the entire expected output. In *Ford Motor Co. v. Comm'r*, Ford argued that a deduction of the full nominal value of expected output from twenty structured settlements was proper. *Ford Motor Co. v. Comm'r*, 102 T.C. 87, 90 (1994). This would have amounted to a nearly \$24.5 million deduction. *Id.* However, the Tax Court ruled in favor of the commissioner, allowing only the deduction of cost of the annuities purchased. See *id.* at 104–05. The Sixth Circuit affirmed. *Ford Motor Co. v. Comm'r*, 71 F.3d 209 (6th Cir. 1995).

63. See Andrada, *supra* note 36, at 482.

from an income tax perspective. Together, they allow a smaller, immediately deductible payment from defendant, to create a larger payment for plaintiff.<sup>64</sup>

Defendant could of course pay the periodic payments to the plaintiff itself, taking an ordinary business deduction for each payment. However, in doing so, plaintiff would remain a mere general creditor.<sup>65</sup> Unfortunately, if defendant becomes insolvent under these conditions, plaintiff would be forced to stand in line with other creditors.<sup>66</sup> Section 130 changes that by encouraging defendants to pay the principal amount to an insurance company, hopefully a responsible one.<sup>67</sup> Thereafter, defendant's financial position is of no concern to plaintiff. Moreover, changes to the Tax Code in 1988 allow for structured settlement payees to have rights beyond those of a general creditor.<sup>68</sup>

Of course, there is another, perhaps more significant benefit to defendants. Defendants and their liability insurers can save anywhere between 10% and 30% by using a structured settlement.<sup>69</sup> This will be discussed in Part III.

Perhaps the simplest way to quantify the value of the tax exemption<sup>70</sup> is to compare the rate-of-return that a lump-sum investment would have to obtain, before taxation, in order to result in the same

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64. *See id.*; JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

65. Risk, *Structured Settlements*, *supra* note 19, at 875.

66. *Id.*

67. Some have also observed that life insurance companies benefit from the tax treatment. 1999 *Hearing*, *supra* note 15, at 28 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (“[A] Life Insurance Company gets to sell their annuity policies at very competitive rates. In turn, they put that money to work on investments earning large returns for themselves which far exceed the rate at which the annuities were placed. . . . It is not difficult to see the large profits the Life Insurance Companies enjoy . . .”); Rudnitsky & Blyskal, *supra* note 9, at 29 (“Life Insurance Co. of North America isn’t hurting either. Its payments guarantee an 8% return, but with long-term Treasury bonds now selling for 12%, LINA can actually do far better.”).

68. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342, 3709–10 (1988).

69. Scales, *supra* note 2, at 880; *see 1999 Hearing*, *supra* note 15, at 28 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting savings of 15% to 20%); Neff E-mail, Feb. 23, 2009, *supra* note 32 (reporting a generally used estimate of 20% as a value of the tax subsidy).

70. At this point, we assume that defendant pays the same amount to the structured settlement company as it would to the plaintiff in a lump-sum settlement. We do so in order to quantify the entirety of the benefit. However, the benefit is likely shared by both parties. *See infra* Part IV.

after-tax rate-of-return of a structured settlement annuity.<sup>71</sup> As seen in the table below, a lump-sum settlement recipient in the 28% income tax bracket would have to invest at a 6.94% rate-of-return<sup>72</sup> in order to obtain the earnings that a structured settlement recipient would obtain by using an annuity with a rate-of-return of only 5%.<sup>73</sup>

TABLE 1: COMPARISON OF LUMP-SUM INVESTMENT RATE-OF-RETURN WITH AFTER-TAX RATE OF RETURN FOR STRUCTURED SETTLEMENT ANNUITY<sup>74</sup>

Structured Settlement Internal Rate of Return	15% Tax Bracket	28% Tax Bracket	33% Tax Bracket	35% Tax Bracket
5.00%	5.88%	6.94%	7.46%	7.69%
6.00%	7.06%	8.33%	8.96%	9.23%
7.00%	8.24%	9.72%	10.45%	10.77%
8.00%	9.41%	11.11%	11.94%	12.31%

71. Were a lump-sum to be invested as an annuity, the earnings would be taxed pursuant to section 72. I.R.C. § 72 (2006) (“[G]ross income includes any amount received as an annuity.”). The earnings would be taxed according to the tax bracket of the taxpayer. I.R.S. Priv. Ltr. Rul. 2005-37-043 (June 23, 2005) (“Under section 72 of the Internal Revenue Code, any amount received under an annuity contract is taxable as ordinary income except to the extent it represents a return of your previously taxed investment in the contract.”); I.R.S. Priv. Ltr. Rul. 2000-30-013 (July 28, 2000) (“In general, section 72 provides that distributions under an annuity contract will be taxed as ordinary income, subject only to reducing the taxable portion of the payments by an amount attributable to the annuitant’s investment in the contract.”).

72. This assumes that the investment is taxed at the ordinary income tax rate, which would be the case if the taxpayer invested in an annuity. See *supra* note 71. The table provided is based on investments in a bank’s certificate of deposit, or CD. MATT GARRETSON & GUY KORNBLUB, *NEGOTIATING AND SETTLING TORT CASES* § 18:7 (2009). NSSTA provides a comparison where \$100,000 structured settlement and \$100,000 lump-sum investment produce similarly scheduled payments. Assume a federal income tax rate of 27%, a state income tax rate of 5%, an equal growth interest rate of 6%, and that the structured settlement pays out \$500 per month for living expenses over twenty years. Under that scenario, NSSTA projects that the structured settlement will payout approximately \$214,000, while the lump-sum will only net approximately \$160,000. National Structured Settlements Trade Association, *Taxable Portfolio vs. Tax-Free Structured Settlement*, <http://www.nssta.com/i4a/pages/index.cfm?pageid=3501> (last visited Jan. 20, 2009).

73. GARRETSON & KORNBLUB, *supra* note 72, § 18:7. The then president-elect for the trade association in Austin, Texas said that a structured settlement with a 6 or 7% rate-of-return for someone in the 40% tax bracket equates to the same earnings as a taxed rate-of-return at 11%. *A Roundtable*, *supra* note 10, at 79 (comments of Herb Cumming); Amy J. Conner, *Structured Settlements: The Basics*, *LAWYERS WEEKLY USA*, Aug. 6, 2001, at 2, available at [http://www.jmwsettlements.com/structured\\_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf](http://www.jmwsettlements.com/structured_settlements/Article%20Reprints/LawyersWeeklyGrillo080601.pdf).

74. GARRETSON & KORNBLUB, *supra* note 72, § 18:7; 4Structures.com, *Taxable Equivalent Yield Chart*, <http://www.4structures.com/4structures/front/resources/tem>

Even those in the 15% tax bracket can earn an additional 1% interest on investments. Over a period of many years, that amounts to a substantial increase in total wealth. Of course, the exemption is more valuable for those with higher tax rates.<sup>75</sup> However, those in the industry believe that the majority of claimants are net taxpayers.<sup>76</sup> Thus, it can benefit most claimants.

## II.

### STRUCTURED SETTLEMENTS: BIRTH, SUBSIDY, JUSTIFICATION, AND DOCTRINE

Many point to 1968 as the first year of structured settlements.<sup>77</sup> Not until the late 1970s and early 1980s did the method begin to grow at exponential rates.<sup>78</sup> The increasing use of structured settlements, rather than lump-sum payments, has been called “one of the most striking developments in the tort payment structure.”<sup>79</sup>

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plate/resources\_tools\_taxable-equivalent-yield-structured-settlement.jsp (last visited Apr. 13, 2009) (providing the same statistics as the Garretson treatise, and more). One NSSTA attorney agrees that the table illustrates the increase in value that one can obtain through the tax subsidy. E-mail from Craig H. Ulman, Counsel to NSSTA to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 14, 2009 11:44:22 EDT) (on file with author). However, he correctly observes that the table compares a structured settlement annuity’s performance with that of a CD, which cannot produce the same type of scheduled payments. *Id.* (noting that for this reason the comparison may be “poor”). Of course, the return rates listed may be somewhat high for the current economic climate.

75. See Rudnitsky & Blyskal, *supra* note 9, at 29 (quoting attorney Fred Levin) (describing how the exemption would prevent a 70% income tax rate from transforming 15% interest earnings on an invested lump-sum into 4.5%).

76. Neff E-mail, Feb. 23, 2009, *supra* note 32. *Contra* E-mail from Joseph Tombs, Partner, Amicus Financial Advisors LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (June 10, 2009, 8:57:37 EST) (on file with author) (estimating that 30% of structured settlement recipients actually receive a significant reduction in their future income taxes). One commentator questions such statistics: “Where is the objective proof? Many structured settlement industry ‘beliefs’ don’t square with the facts.” Hindert E-mail, Sept. 4, 2009, *supra* note 45 (citing Babener, *supra* note 2).

77. See Brian Brown & Lisa Chalidze, *Structured Settlements: An Overview*, 22 VT. B.J. & L. DIG. 14, 14 (1996); Thomas C. Downs, *Superfund Colloquium: Periodic Payment of Claims: New Hope for CERCLA Settlements?*, 8 TUL. ENVTL. L.J. 387, 402 (1995) (citing Panel Discussion, *Annuities to Settle Cases*, 42 INS. COUNS. J. 367, 370–77 (1975)). *But see* Riccardi & Ireland, *supra* note 15, at 7 (suggesting that it was only in 1968 that they became “widely used”); Brown & Chalidze, *supra*, at 14 (suggesting that the structured settlements were merely “given a boost” by the Thalidomide cases).

78. See *infra* Part II.A.

79. Ellen S. Pryor, Symposium, *Liability for Inchoate and Future Loss*, 88 VA. L. REV. 1757, 1763 (2002).

This section narrates the beginnings of structured settlements, their initial tax treatment by the IRS, and the subsequent legislation codifying and expanding their favorable treatment. In doing so, the section takes note of the initial belief that the doctrines of constructive receipt<sup>80</sup> and economic applied benefit.<sup>81</sup> These doctrines demand that structured settlement recipients, in order to take advantage of the beneficial tax treatment, not obtain control over the annuities purchased to fund their payments. The importance assigned to these doctrines corresponds with the legislation's presumed, and later declared justification to discourage personal injury claimants from quickly dissipating awards or settlement monies within their control.

Part III will then detail the eventual deconstruction of these two doctrines as applied to structured settlements.

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80. Tax regulations supply a definition of constructive receipt:

Income although not actually reduced to a taxpayer's possession is *constructively received* by him in the taxable year during which it is credited to his account, set apart for him, or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Treas. Reg. § 1.451-2(a) (as amended in 1979) (emphasis added).

81. In *Sproull v. Commissioner*, the Tax Court found that despite an employee's non-involvement in the creation of a trust that deferred payments from the employer to a later date, the question was only whether "any economic or financial benefit [was] conferred on the employee as compensation." *Sproull v. Comm'r*, 16 T.C. 244, 247 (1951), *aff'd*, 194 F.2d 541 (6th Cir. 1952) (citing *McEwen v. Comm'r*, 6 T.C. 1018 (1947)). The court found that the fund was

ascertained and paid for by petitioner's employer for his benefit in that year. Petitioner had to do nothing further to earn it or establish his rights therein. . . . No one else had any interest in or control over the monies. The trust agreement contained no restriction whatever on petitioner's right to assign or otherwise dispose of the interest thus created in him.

*Id.* at 248. Thus, the transfer of funds into the trust was held to be taxable income of the employee. *Id.* at 247-48. Several courts since have used the *Sproull* approach. A later Tax Court defined the doctrine: "Under the economic-benefit theory, an individual on the cash receipts and disbursements method of accounting is currently taxable on the economic and financial benefit derived from the absolute right to income in the form of a fund which has been irrevocably set aside for him in trust and is beyond the reach of the payor's debtors." *Pulsifier v. Comm'r*, 64 T.C. 245, 246 (1975) (citing *Sproull*, 16 T.C. at 247-48). In 1993, the economic benefit doctrine was applied in a technical advice memo to hold, "a service recipient's creation of a fund in which a service provider has vested rights will result in immediate inclusion of the amount funded in the service provider's gross income." I.R.S. Priv. Ltr. Rul. 93-36-001 (May 12, 1993). Some commentators, however, have argued that the economic benefit doctrine has been eroded through misapplication. See Gordon T. Butler, *Economic Benefit: Formulating a Workable Theory of Income Recognition*, 27 SETON HALL L. REV. 70, 103, 115 (1996).

A. *The Birth and Growth of Structured Settlements*

Though commentators have yet to determine who coined the term “structured settlements,” many point to a set of Canadian Thalidomide cases,<sup>82</sup> against the drug manufacturer Richardson-Merrill.<sup>83</sup> Plaintiffs argued that the company’s sleeping pill caused severe and permanent physical handicaps in the children of women who used it during pregnancy.<sup>84</sup> To settle the case, defendant agreed to make periodic payments to plaintiffs.<sup>85</sup> The subsequent rise of structured settlements in the next decade has been attributed to different triggers. Among them, some point to the increase in personal injury cases,<sup>86</sup> specifically “mass personal injury” cases.<sup>87</sup> As will be seen, the tax treatment was probably the largest factor.

As of 1976, the structured settlement market was worth approximately \$5 million.<sup>88</sup> This quickly changed with IRS rulings in 1979 and congressional action in 1982,<sup>89</sup> discussed in Part I.B–C. Over the next quarter century, the structured settlement market grew rapidly.

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82. See Brown & Chalidze, *supra* note 77, at 14 (“Structured settlements as a means of resolving lawsuits date back to the 1960s, and were given a boost by the massive litigation triggered by the drug thalidomide . . .”).

83. Kenneth K. Keene & Robert J. Ross, *Structured Settlements*, BUS. INS., Apr. 28, 1980, at 25; Downs, *supra* note 41, at 402–04 (citing Panel Discussion, *Annuities to Settle Cases*, 42 INS. COUNS. J. 367, 370–77 (1975)).

84. Downs, *supra* note 41, at 402 (citing Panel Discussion, *Annuities to Settle Cases*, 42 INS. COUNS. J. 367, 370–77 (1975)).

85. See Brown & Chalidze, *supra* note 77, at 14.

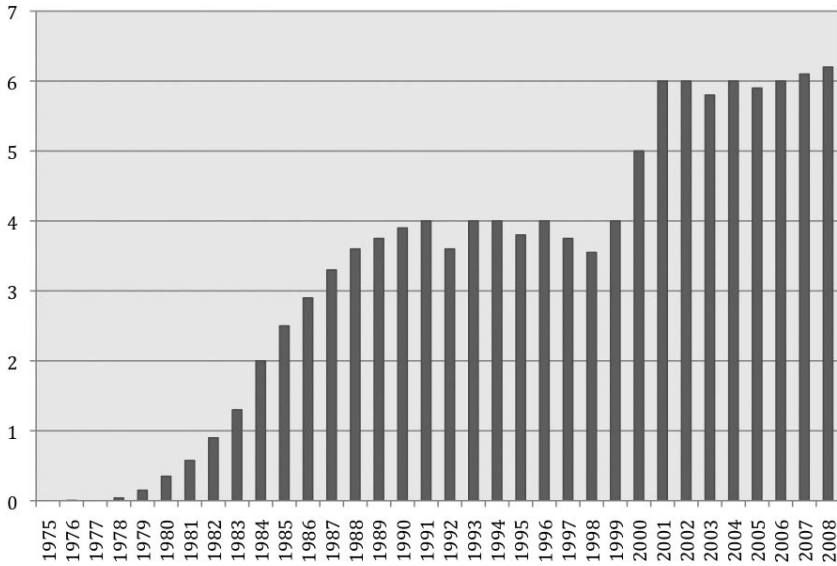
86. REPORT ON PERIODIC PAYMENT OF DAMAGE FOR PERSONAL INJURY AND DEATH, MANITOBA LAW COMMISSION 39 (1987).

87. Andrada, *supra* note 36, at 467 (citing Brown & Chalidze, *supra* note 77, at 14).

88. Riccardi & Ireland, *supra* note 15, at 8.

89. See Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75; Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605, 2605 (1983).

FIGURE 1: STRUCTURED SETTLEMENT ANNUITY SALES IN BILLIONS OF DOLLARS<sup>90</sup>



From \$5 million in 1976,<sup>91</sup> and fewer than 3,000 cases in 1979, the market expanded to \$1.5 billion in 1983, spread over 15,000 cases.<sup>92</sup> By the early 1990s, twenty life insurance companies were selling structured settlement annuities,<sup>93</sup> and the market had grown to \$4 billion.<sup>94</sup> In 1997, a large survey found that 12% of commercial liability physical injury claims settled by way of structured settle-

90. The data was provided by Structured Financial Associates, Inc. E-mail from Melissa Evola, Vice President of Business Development, Structured Financial Associates, Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 27, 2009, 17:19:10 EST) (on file with author) [hereinafter Evola E-mail]. Their data incorporates data through 2002 from a structured settlement treatise, DANIEL W. HINDERT ET AL., *STRUCTURED SETTLEMENTS AND PERIODIC PAYMENT JUDGMENTS* § 1.03[1] (2009), and has been the treatise's source thereafter. Evola E-mail, *supra*.

91. Riccardi & Ireland, *supra* note 15, at 8.

92. Phillip L. Kennerly, *Structured Settlements: A Useful Tool for the Claims Judge Advocate*, 1986 *ARMY L.* 12, 12 n.3 (1986) (citing Denninger, Bellamy & Terue, *Anatomy of a Structured Settlement*, *CASE & COMMENT*, Feb. 1985, at 26). Other estimates put the value at over \$2 billion in 1982. Kennerly, *supra*, at 128 (quoting Staller, *The Basics of Structured Settlements*, *PRAC. LAW.*, Jan. 15, 1984, at 75). Some attribute their popularity in the early 1980s, at least in part, to annuities' then impressive double-digit rates-of-return. Risk, *Structured Settlements*, *supra* note 19, at 877.

93. Downs, *supra* note 41, at 403 n.83 (citing *Structured Settlements; How to Make Sure You Don't Lose in 'Win-Win' Deals*, *BUS. INS.*, Nov. 25, 1991, at 25).

94. Risk, *Structured Settlements*, *supra* note 19, at 878.

ments.<sup>95</sup> Nearly 25% of the claims in excess of \$300,000 involved structured settlements.<sup>96</sup> Based on the available statistics,<sup>97</sup> the average value of a structured settlement annuity premium is approximately \$177,000.

In 2002, NSSTA reported \$6.12 billion in annuity premium sales by its members.<sup>98</sup> By 2004, NSSTA estimated that over \$400 billion of structured settlement payouts had already been made to 500,000 structured settlement recipients.<sup>99</sup> An organization that has tracked the growth of the industry reports that over 35,000 structured settlement annuities were sold in 2008,<sup>100</sup> accounting for \$6.2 billion.<sup>101</sup> Some estimate that more than \$100 billion of previously structured settlements currently exist.<sup>102</sup>

95. ISO SURVEY, *supra* note 13, at 22.

96. *See id.* Reportedly, a NSSTA survey found that 7% of settlements between \$75,000 and \$100,000, and 30% of settlements over \$1 million, use structured settlements. Hindert, *supra* note 16.

97. *See* Hindert, *supra* note 16 (providing the estimated total number of structured settlements, which can be used to calculate the average value of structured settlements when combined with the annual value of total structured settlement annuity premiums).

98. Risk, *A Case*, *supra* note 7, at 644 n.13 (citing Press Release, Peter Arnold, NSSTA, Structured Settlements Industry Maintains Surging Popularity in 2002 (Jan. 30, 2003)); *cf.* Scales, *supra* note 2, at 882 n.72 (citing Press Release, National Structured Settlements Trade Association, Structured Settlements Industry Reports 19 Percent Surge in Demand During 2001; \$6.05B Is Best Year in History (Feb. 5, 2002)).

99. HINDERT ET AL., *supra* note 90, § 1.03[1] (citing Report of National Structured Settlements Trade Association President Mal Deener to NSSTA Annual Meeting (May 1, 2004)).

100. Evola E-mail, *supra* note 90. In 2001, 50,000 to 60,000 tort claims were settled using structured settlements. Scales, *supra* note 2, at 882. It is unclear if that number is accurate, as the author has not found sources tracking the number of sales prior to 2008. If the 50,000 to 60,000 number is accurate, there is a real question of why the number has decreased to 35,000 while the value of sales have increased.

101. Evola E-mail, *supra* note 90. In the past, some have estimated the value to reach some \$10 billion, 1999 Hearing, *supra* note 15, at 78 (written statement of J.G. Wentworth, a finance company that purchases and securitizes structured settlements), or even \$12 billion. Riccardi & Ireland, *supra* note 15, at 8 (citing <http://www.nsstta.com>). AIG sold the most structured settlement annuities, with nearly \$1.5 billion. Evola E-mail, *supra* note 90. After AIG comes Prudential, with \$986 million, MetLife, with \$857 million, Hartford, with \$767 million, Aviva, with \$504 million, John Hancock, with \$489 million, New York Life, with \$361 million, Allstate, with \$280 million, Pacific, with \$274 million, Liberty, with \$240 million, and Symetra, with \$14 million. *Id.* One treatise notes that the steady volume of structured settlements “indicates a mature market.” HINDERT ET AL., *supra* note 90, § 1.03[1].

102. *See, e.g.*, Daniel W. Hindert & Craig H. Ulman, *Transfers of Structured Settlement Payment Rights: What Judges Should Know About Structured Settlement Protection Acts*, 44 JUDGES’ J. 19, 19 (2005).

It seems to be roundly agreed upon that “[t]he \$6,000,000,000 market for structured settlement annuities owes its existence almost entirely to the tax subsidy.”<sup>103</sup>

*B. The Two Revenue Rulings that Changed Everything*

The tax treatment of structured settlements was initially established in 1979.<sup>104</sup> The IRS issued two revenue rulings interpreting section 104(a)(2) in relation to structured settlements, Rev. Rul. 79-220,<sup>105</sup> and Rev. Rul. 79-313.<sup>106</sup> Each allowed the exclusion of periodic payments for personal injury settlements.<sup>107</sup>

Rev. Rul. 79-220 permitted a plaintiff to exclude from income the nominal value of periodic settlement payments when received, rather than their discounted present value at the time of the settlement.<sup>108</sup> In deciding, the ruling took specific note of the fact that the settlement did not give any rights to the plaintiff in the annuity purchased by defendant’s insurer.<sup>109</sup> Ultimately, the plaintiff neither had “actual [*n*]or constructive receipt [*n*]or the economic benefit of the lump-sum amount that was invested to yield [the monthly settlement payments].”<sup>110</sup> The ruling likened the situation to that of an employer providing deferred compensation.<sup>111</sup> There as well, “the arrangement [is] merely a matter of convenience to the obligor and [does] not give the recipient any right in the annuity itself.”<sup>112</sup>

Rev. Rul. 79-313 permitted a plaintiff to exclude from income annual payments made pursuant to a settlement agreement, regardless of the fact that the payment amounts increased by a set percentage each year.<sup>113</sup> Of central importance was the fact that the taxpayer had “neither actual *nor* constructive receipt, *nor* the economic benefit of the present value of the damages.”<sup>114</sup> Having received neither control

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103. Scales, *supra* note 2, at 895 (citing *A Roundtable*, *supra* note 10, at 72 (comments of Charles Krause); *1999 Hearing*, *supra* note 15, at 24–25 (Statement of Timothy J. Frankina, Chief Executive Officer, Peachtree Settlement Funding)); *cf.* Meligan Interview, *supra* note 31 (suggesting that fewer structured settlements would occur without the tax benefits).

104. *See* Riccardi & Ireland, *supra* note 15, at 8.

105. *See* Rev. Rul. 79-220, 1979-2 C.B. 74.

106. *See* Rev. Rul. 79-313, 1979-2 C.B. 75.

107. *See* Rev. Rul. 79-220, 1979-2 C.B. 74; *see* Rev. Rul. 79-313, 1979-2 C.B. 75.

108. *See* Rev. Rul. 79-220, 1979-2 C.B. 74.

109. *See id.*

110. *Id.* (emphasis added).

111. *See id.* (citing Rev. Rul. 72-75, 1972-1 C.B. 127).

112. *Id.* (citing Rev. Rul. 72-75, 1972-1 C.B. 127).

113. *See* Rev. Rul. 79-313, 1979-2 C.B. 75.

114. *Id.* (emphasis added).

nor guaranteed benefit of the future payments, a taxpayer need not include such monies in their taxable income. Thus, again we see the application and significance of the two doctrines.

### C. Codification and More

Structured settlements increased in usage after 1979, as noted, but defendants purchasing annuities to make the periodic payments were only able to deduct those payments as business expenses as the money was distributed to plaintiffs.<sup>115</sup>

In an attempt to alter this disadvantageous position, and thus make structured settlements more attractive to casualty and liability insurers, IBAR Inc. hired a lobbyist, David M. Higgins, a Los Angeles tax attorney, to persuade Congress to enact legislation providing such a deduction.<sup>116</sup> Mr. Higgins worked with the IRS to draft such a law, as well as the Congressional Budget Office.<sup>117</sup> The bill was intro-

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115. See Risk, *Structured Settlements*, *supra* note 19, at 873–74.

116. *Id.* at 874. IBAR Settlement Co., Inc. was advised that even if the legislative attempt failed, it would show that there had been a good faith effort to clarify the issue. E-mail from Stan Schultz, CEO, IBAR Settlement Co., Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 27, 2009, 21:05:01 EST) (on file with author) [hereinafter Schultz E-mail].

117. Risk, *Structured Settlements*, *supra* note 19, at 874. IBAR first approached Congressman Barry Goldwater, Jr. Schultz E-mail, *supra* note 116. However, Congressman Goldwater, Jr. was soon embroiled in a drug scandal. *Id.* See generally *House Drug Query Is Assailed*, N.Y. TIMES, NOV. 19, 1983, at § 1. Thereafter, IBAR hired the firm of Manett, Phelps, and Phillips, which provided former Congressman James Corman to lobby the “IBAR Bill.” Schultz E-mail, *supra* note 116. At the same time, a group of structured settlement brokers attempted to secure a private letter ruling on similar issues. *Id.* Though they were advised by the IRS to withdraw the request, they did not. *Id.* Thereafter, an adverse private letter ruling was issued. *Id.*; see I.R.S. Priv. Ltr. Rul. 82-48-073 (Aug. 31, 1982). Interestingly, a private letter ruling issued two years prior had already secured the substance of what the 1982 ruling decided against, and what the subsequent legislation would soon codify. See I.R.S. Priv. Ltr. Rul. 80-38-044 (June 24, 1980) (finding a transfer of funds to a structured settlement company equivalent to a loan transaction, and thus not taxable). Though there was no opposition to the original contents of the bill, its many unrelated amendments prevented passage in its first form as the Periodic Payment Settlement Act of 1981. Schultz E-mail, *supra* note 116. In fact, it was referred to in Congress as “The Christmas Tree Bill,” an initially uncontroversial bill that attracted amendments because congressmen believed it would pass. *Id.* Before passing H.R. 5470 on October 1, 1982, 128 CONG. REC. S26,905 (1982) (statement of the Presiding Officer), the Senate attached to it five “nongermane amendments.” 128 CONG. REC. H30,352 (1982) (statement of Rep. Rostenkowski) (noting amendments concerning the Highway Trust Fund, the Hawaiian Prepaid Health Care Act, and tax-related amendments concerning foster care payments, Indian tribal governments, and income in the Virgin Islands). Before submitting the bill to Conference, the House attached a non-germane amendment of its own. 128 CONG. REC. H30,352 (1982) (clarifying government responsibilities in regulating “multiemployer health trusts”). The Conference report, agreed to by both houses soon after its release, 128 CONG. REC. H33,263

duced separately by several legislators.<sup>118</sup>

The Periodic Payment Settlement Tax Act of 1982 codified the two 1979 revenue rulings<sup>119</sup> by amending section 104(a)(2), but went further, creating section 130.<sup>120</sup> Interestingly, Congress avoided providing substantive justifications.<sup>121</sup> Moreover, Congress repeated its evasion when amending the law in 1988,<sup>122</sup> 1996,<sup>123</sup> and 1997.<sup>124</sup>

The Periodic Payment Settlement Tax Act of 1982 codified what the previous revenue rulings provided, replacing section 104(a)(2)'s personal injury exclusion language of "whether by suit or agreement" with "whether by suit or agreement *and whether as lump sums or as periodic payments.*"<sup>125</sup> Reports by the Senate Finance Committee and House Committee on Ways and Means cited the benefit to taxpayers of providing "statutory certainty,"<sup>126</sup> even though parallel revenue rulings already existed. They also stated that the provision was "intended to codify, rather than change, present law . . . [and that] periodic payments as personal injury damages are still excludable from income *only if the recipient taxpayer is not in constructive re-*

(1982); 128 CONG. REC. S33,183 (1982), cut the House's amendment and two of the Senate's amendments, but generally agreed to the remaining three. See H.R. REP. NO. 97-984, at 13-21 (1982) (Conf. Rep.); see also 128 CONG. REC. H33,263 (1982) (statement of Rep. Rostenkowski) (referring to the Senate amendments respecting Indian tribal governments, the Hawaiian Prepaid Health Care Act, and the tax treatment of particular foster care payments). After trimming and passage, President Reagan intended to veto the bill. See Schultz E-mail, *supra* note 116 (recalling that the Indian tribal governments amendment was of concern to the President). However, former Congressman James Corman lobbied House Speaker Tip O'Neil, who successfully lobbied the President. *Id.* Thus, the "IBAR Bill" was signed into law. *Id.*

118. H.R. 5470 was substantively identical to H.R. 4356, introduced by Congressmen Goldwater and Rousselot, and H.R. 5732, introduced by Congressman Holland. JOINT COMM. ON TAXATION, 97TH CONG., DESCRIPTION OF TAX BILLS (H.R. 4467, H.R. 4948, H.R. 5177, H.R. 5470, AND H.R. 5573 12 n.1 (Comm. Print 1982)). H.R. 4356 and H.R. 5732, unlike H.R. 5470, would have taken effect earlier. *Id.*

119. See Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75; see also JOINT COMM. ON TAXATION, 97TH CONG., DESCRIPTION OF TAX BILLS (H.R. 4467, H.R. 4948, H.R. 5177, H.R. 5470, AND H.R. 5573 12-13) (Comm. Print 1982).

120. See generally Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, 96 Stat. 2605.

121. See *id.*; see also S. REP. NO. 97-646 (1982).

122. See Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079, 102 Stat. 3709 (1988).

123. See Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1605, 110 Stat. 1755, 1838 (1996); see also H.R. REP. NO. 104-586 (1996).

124. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 962(a), 111 Stat. 788, 891 (1997).

125. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605 (emphasis added).

126. H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 3 (1982).

*ceipt of or does not have the current economic benefit of the sum required to produce the periodic payments.*"<sup>127</sup>

In addition to the codification, the Act inserted section 130 into the tax code, excluding from gross income amounts received by structured settlement companies for accepting a qualified assignment.<sup>128</sup> The addition was passed over certain objections by the Treasury<sup>129</sup> and the life insurance industry.<sup>130</sup>

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127. H.R. REP. NO. 97-832, at 4 (1982) (emphasis added); S. REP. NO. 97-646, at 3-4 (1982) (emphasis added).

128. See Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(b)(1), 96 Stat. 2605. See generally I.R.C. § 130 (2006). Fifteen years later, in response to lobbying by the National Structured Settlements Trade Association, see Risk, *Structured Settlements*, *supra* note 19, at 886 (citing Letter from Legislation and Regulations Committee, NSSTA, to NSSTA Member Companies (Apr. 1997)), the Taxpayer Relief Act of 1997 amended section 130, extending the exemption to worker's compensation payments. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 962(a), 111 Stat. 788, 891 (1997).

129. See *Miscellaneous Tax Legislation: Hearings Before the Subcomm. on Select Revenue Measures of the Comm. on Ways and Means*, 97th Cong. 7 (1982) [hereinafter *1982 Hearing*] (statement of John E. Chapoton, Assistant Secretary for Tax Policy, Treasury Department) (objecting because "[o]ur reading is that it goes beyond existing law"). Because structured settlement annuity earnings would neither be taxable to defendant or plaintiff, Treasury argued that "income slips through the system." *Id.* at 7. In doing so, Treasury believed the bill to create "a substantial new benefit to third parties that assume obligations to make periodic damage payments." *Id.* at 14 (written statement of John E. Chapoton). Having heard Treasury testimony, Committee Chairman Pete Stark transitioned to the next witness: "I am sure the gentlemen will now proceed to destroy the testimony of the Secretary of the Treasury. You may proceed to do that in any manner you see fit." *Id.* at 81 (statement of Pete Stark, Chairman of the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means). IBAR Settlement Co., Inc. lobbyist later responded to the Treasury statements: "I think the Treasury has misread [this] bill . . . I am hopeful we can work out with Treasury their objections because we certainly are not in here looking for anything special. We do not want any excess deductions and we do not want any extraordinary exclusions . . ." *Id.* at 88-89 (written statement of David M. Higgins, Esq., Overton, Lyman, & Prince). Interestingly, no one pointed to the previously discussed 1980 private letter ruling holding that monies transferred to a structured settlement company were excludable as the equivalent of a loan transaction. See I.R.S. Priv. Ltr. Rul. 80-38-044 (June 24, 1980). A contrary ruling in 1982 was also not discussed. See I.R.S. Priv. Ltr. Rul. 82-48-073 (Aug. 31, 1982).

130. *1982 Hearing*, *supra* note 129, at 113 (statement of the American Council of Life Insurance) ("Specifically, we are troubled by the provision of the bill which allows such assignees an exclusion from income for amounts received and applied to satisfy assumed damage obligations, yet does not in any way specify when, or how, the assignee must use the amounts received to fund the damage payments . . . . [W]e can see no justification for giving free rein to entities not subject to the rigorous solvency and reserve accounting standards applicable to insurers to provide such statements . . . . For these reasons, we urge that H.R. 5470 be withdrawn, at least insofar as it specifies the tax treatment to be given third party payors of structured annuity damage amounts.").

*D. Extrapolating a Justification from the Legislative History*

While the committee reports for the Periodic Payment Settlement Tax Act of 1982 convey little about Congress's preference between structured settlements and lump-sum settlements, allowing for both, legislative history of the Act's 1981 predecessor and the 1982 Act's committee hearing provide insight. Concern for the "*Squandering Plaintiff*,"<sup>131</sup> one who accepts a lump-sum and prematurely dissipates it, was frequently cited. The justification fits well alongside the reference to the constructive receipt and economic benefit doctrines, which require that a claimant not control received settlement monies. By preventing such control, premature dissipation becomes difficult, if not impossible.

Prior to introducing the Periodic Payment Settlement Tax Act of 1982,<sup>132</sup> Senator Max Baucus<sup>133</sup> introduced a very similar Periodic Payment Settlement Act of 1981.<sup>134</sup> Senator Baucus argued that the lump-sum settlement approach "has proven unsatisfactory . . . in many cases because it assumes that injured parties will wisely manage large sums of money so as to provide for their lifetime needs. In fact, many of these successful litigants, particularly minors, have dissipated their awards in a few years and are then without means of support."<sup>135</sup> In contrast, he went on, structured settlements "provide plaintiffs with a steady income over a long period of time and insulate them from pressures to squander their awards."<sup>136</sup>

One year later, in Committee hearings on the bill for the 1982 Act, similar assertions of plaintiff irresponsibility were introduced by Patrick J. Hindert,<sup>137</sup> the later author of a leading structured settlement

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131. See Scales, *supra* note 2, at 869 (discussing this oft-cited argument).

132. See 144 CONG. REC. S11, at 499–01 (1998) (statement of Sen. Baucus).

133. Max Baucus is currently Montana's Senior U.S. Senator, and Chairman of the Senate Finance Committee. See Max Baucus Newsroom, <http://baucus.senate.gov/?p=newsroom> (last visited Feb. 1, 2009).

134. See The Periodic Payment Settlement Act of 1981, S. 1934, 97th Cong. (2d Sess. 1981).

135. 127 CONG. REC. 30,462 (Dec. 10, 1981) (statement of Sen. Baucus) (introducing the Periodic Payment Settlement Act of 1981).

136. *Id.*

137. See 1982 Hearing, *supra* note 129, at 82, 84 (statement of Patrick J. Hindert, President of Benefit Designs, Inc., a consulting firm for personal injury case parties) (testifying that lump-sum plaintiffs "are frequently back on the public dole" due to the dissipation of their award, and that lump-sum recipients are "frequently ill-equipped psychologically, physically or educationally to assume the investment and mortality risks associated with managing money to satisfy anticipated future financial requirements").

treatise,<sup>138</sup> and David Higgins,<sup>139</sup> the attorney hired by IBAR Settlement Co., Inc., to lobby Congress.<sup>140</sup>

The legislative history for the Periodic Payment Settlement Tax Act of 1982 suggests that the prematurely dissipating plaintiff was a, if not the primary, justification for the legislation. This was true even though structured settlement annuities are subject to risks of inflation<sup>141</sup> and insurer failure.<sup>142</sup> Senator Baucus, Mr. Hindert, and Mr. Higgins each suggested that the problem of lump-sum dissipation ex-

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138. See generally HINDERT ET AL., *supra* note 90.

139. See 1982 *Hearing*, *supra* note 129, at 87 (written statement of David M. Higgins, Esq., Overton, Lyman, & Prince) (“The use of a periodic payment settlement assures the availability of future compensation for lost support and care as those costs are incurred. Plaintiffs receiving periodic payments truly are protected from their own ill-conceived actions and the advice of others. If a payment or several payments are dissipated, future compensation for future costs continues to be available . . . . The payment of a substantial lump sum often does not mitigate those economic losses in the long run, even if the amounts are theoretically adequate, because few people are capable of investing a large lump sum to assure security, liquidity, and an appropriate rate of return for their future needs. They often are ill-advised by friends, relatives, and even professional managers, and some are natural spend-thrifts in any event.”).

140. Telephone Interview with Stan Schultz, CEO, IBAR Settlement Co., Inc. (Apr. 8, 2009).

141. An annuity requires a payee to bind oneself to set future periodic payments. Some have criticized such binding because the plaintiff risks the possibility that inflation will be higher than estimated. See, e.g., Riccardi & Ireland, *supra* note 15, at 12; see also J. Thomas Romans & Frederick G. Floss, *Structured Settlements and the Interest Rate Switch*, 12 J. FORENSIC ECON. 57, 60 (1999); Yandell, *supra* note 50, at 73. If so, the value of the annuity payments decrease, and the annuity cannot be converted into other investments. See Joseph Kelner & Robert S. Kelner, *Trial Practice, Variable Income Annuity Structured Settlements*, N.Y.L.J., June 27, 2000. Of course, the lack of future knowledge is a “two edged sword.” Riccardi & Ireland, *supra* note 15, at 12. If the rate of inflation is lower than projected, the annuity’s payments will have greater value. And, in fact, one study found the internal rates of structured settlements to historically outperform Treasury bill rates 78.52% of the time. See Romans & Floss, *supra*, at 64. It is unclear what occurs during the remaining 21.48% of the time. See *id.*

Some structured settlements do not account for inflation at all. See I.R.S. Priv. Ltr. Rul. 94-37-028 (Sept. 17, 1994) (ruling that inflation does not effect the structured settlement tax exemption). This places claimants at far greater risk of increases in inflation. Meligan Interview, *supra* note 31. One plaintiff-side structured settlement planner recommends not indexing a structured settlement annuity to inflation for clients over forty years of age. *Id.* This is because an indexed annuity’s increasing nominal payments will often not reach the non-indexed payments of decreasing value for over twenty-five years, by which time a claimant will likely not have many years of payments left. *Id.*

One might ask why Congress allows claimants to risk the loss of their award or settlement by betting on low inflation. Mandating the indexing of structured settlement annuities to inflation might be more in line with the original purpose of the tax subsidy. On the other hand, the fear of the prematurely dissipating plaintiff might have been solely aimed at poor purchasing, not poor investing. This defense will be relevant in the next section as well.

isted, and required a solution. Interestingly, such rhetoric was not included in the committee reports.<sup>143</sup>

### *E. Congressional Justifications in Hindsight*

Though the legislative history suggests that Congress's purpose was to discourage plaintiff lump-sum dissipation, commentators and courts had no congressionally adopted justifications to rely on.<sup>144</sup> Thus, for nearly two decades they hypothesized. Some suggested that periodic payments are excluded simply because personal injury damages are excluded,<sup>145</sup> others that Congress believed structured settlements would prevent plaintiffs from later government dependence.<sup>146</sup>

In 1998 and 1999, however, in the midst of considering how to discourage former plaintiffs from selling their structured settlement without court approval,<sup>147</sup> the justification question was addressed, and largely answered.

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142. One risk inherent to structured settlements is the possibility that the insurer making the periodic payments will not be able to pay, though this has not yet occurred. *See* Riccardi & Ireland, *supra* note 15, at 11. Though the 2008 crisis has brought fear and concern about bank security, structured settlements have several protections for payees. National Structured Settlements Association, *supra* note 57. Such companies must maintain assets above a required reserve ratio, though many reserve more. *Id.* State regulators retain authority to help move companies toward restructuring in the event of financial insecurity. *Id.* And, state insurance guaranty associations offer protection somewhat similar to the Federal Deposit Insurance Corporation, making some periodic payments possible if an insurance company stops making payments. *Id.* However, there are significant limitations in each state preventing insurance agents and brokers from publicly or privately using the existence of guaranty corporations to encourage the use of annuities. *See, e.g.,* N.Y. INS. LAW § 7718 (Consol. 2009). The National Organization of Life & Health Insurance Guaranty Associations keeps a list of the various state statutes. NOLHGA, *State Laws and Provisions Report*, <http://www.nolhga.com/factsandfigures/main.cfm/location/lawdetail/docid/18> (last visited Feb. 9, 2009). It is not clear if guaranty associations will insure factoring companies against life insurance company failures. *See* Bracy Interview, *supra* note 28. There has been recent movement toward specifically excluding factoring companies from such protections. *See id.* Structured settlement planners discuss the possibility of insurer failure with personal injury claimants, but the de minimis risk makes it a very positive discussion. *See* Meligan Interview, *supra* note 31.

143. *See* H.R. REP. NO. 97-832 (1982); S. REP. NO. 97-646 (1982).

144. It seems unlikely that "statutory certainty," *see* H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 4 (1982), led to the bill's passage. Inserting section 130 was not a codification.

145. Blackburn, *supra* note 61, at 685.

146. *See, e.g.,* O'Connell, *supra* note 27; *see also* Mannix, *supra* note 27, at 62 ("In 1982, seeking to prevent accident victims from frittering away large sums intended to provide for them over their lifetimes, Congress instituted tax breaks for those who agreed to receive their money over a period of years.").

147. *Cf.* 1999 Hearing, *supra* note 15, at 6 (statement of Rep. Pete Stark); 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus).

Industry representatives from both the structured settlement companies and structured settlement purchasing companies agreed that the 1982 legislation was passed in response to the danger of premature lump-sum dissipation.<sup>148</sup> Several congressmen, including those involved in the passage of the original legislation, agreed.<sup>149</sup> Lastly, in describing the basis for what it called Congress's "tax subsidy for the use of structured settlement[s],"<sup>150</sup> the Joint Committee on Taxation report agreed.<sup>151</sup>

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148. 1999 *Hearing*, *supra* note 15, at 20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P. on behalf of the National Association of Settlement Purchasers) ("There is no question that one of the reasons motivating [the House Ways and Means Committee on Oversight] to adopt the Periodic Payment Settlement Act of 1982 was that structured settlements are useful in protecting people who cannot protect themselves."); *see id.* at 37 (statement of Thomas W. Little, Former President of National Structured Settlements Trade Association, on behalf of the NSSTA) ("Congress has adopted special tax rules to encourage and govern the use of structured settlements in order to provide long-term financial security for injured victims and their families.").

149. *See id.* at 5 (statement of Rep. Pete Stark) ("The stories of people who received large lump-sum settlements and squandered them were equally heart rending, some ended up back on welfare if they were in fact disabled. It made great good sense then, and I think it makes great good sense now."); *id.* at 6 (statement of Rep. E. Clay Shaw, Jr.) ("Congress was concerned that injured victims would prematurely spend a lump-sum recovery and eventually resort to the social safety net."); 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus) ("[O]ur focus in enacting these tax rules in sections 104(a)(2) and 130 of the Internal Revenue Code was to encourage and govern the use of structured settlements in order to provide long-term financial security to seriously-injured victims and their families and to insulate them from pressures to squander their awards.").

150. JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

151. *Id.* at 7 ("If a recipient chooses a lump sum settlement, there is a chance that the individual may, by design or poor luck, mismanage his or her funds so that future medical expenses are not met. If the recipient exhausts his or her funds, the individual may be in a position to receive medical care under Medicaid or in later years under Medicare. That is, the individual may be able to rely on Federally financed medical care in lieu of medical care that was intended to have been provided by the personal injury award. Such a 'moral hazard' potential *may justify* a subsidy to encourage the use of a structured settlement arrangement in lieu of a lump sum payment to the recipient, to reduce the probability that such individuals need to make future claims on these government programs. Under the structured settlement arrangement, by contrast to the lump sum, it is argued that because the amount and period of the payments are fixed at the time of the settlement, the payments are more likely to be available in the future to cover anticipated medical expenses (assuming the payment stream is not transferred by the recipient).") (emphasis added). While the language "may justify" could be interpreted to indicate a lack of commitment by the Joint Committee, the report strongly indicates agreement that the purpose of the subsidy is to prevent dissipation.

Thus, after nearly two decades, Congress had finally clarified the justification for the “tax subsidy” to structured settlement transactions, namely, the image of the squandering plaintiff.<sup>152</sup>

### III.

#### ALLOWING CONSTRUCTIVE RECEIPT AND ECONOMIC BENEFIT

Though Congress’s actions and writings discussed thus far highlighted the application of the constructive receipt and economic benefit doctrines to structured settlements, the late 1980s marked the beginnings of a complete overhaul. This section narrates the deconstruction of both doctrines, as applied to structured settlements, through two stages. Congress first legislated a reduced application of the economic benefit doctrine in 1988. Then, in the early 1990s, a new and profitable transaction was discovered whereby a company purchases a structured settlement recipient’s future payments, thus conferring the substance of constructive receipt. The IRS and Congress implicitly confirmed recipients’ ability to perform such a transfer.

The two changes substantively destroyed much of the constructive receipt and economic benefit doctrines as applied to structured settlements. On the surface, they seem to detract from Congress’s initially presumed, now known justification for the structured settlement tax subsidy: the discouragement of personal injury claimants from prematurely dissipating lump-sums. However, though the changes transfer at least some control to the claimant, they leave the tax subsidy’s effect intact. As will be shown, they may even have bolstered the subsidy’s effectiveness.

#### A. *Congress’s U-Turn on Plaintiffs’ Need to Avoid Economic Benefit*

Though both revenue rulings and legislative history<sup>153</sup> highlight the importance of preventing plaintiffs from receiving the economic benefit of a structured settlement, that limitation was substantially eroded in 1988.<sup>154</sup>

Originally, section 130 stipulated “the assignee does not provide to the recipient of such payments rights against the assignee which are

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152. See Scales, *supra* note 2, at 869 (discussing this oft-cited argument).

153. See H.R. REP. NO. 97-832, at 4 (1982); S. REP. NO. 97-646, at 4 (1982); Rev. Rul. 79-220, 1979-2 C.B. 74; Rev. Rul. 79-313, 1979-2 C.B. 75.

154. See Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A)–(B), 102 Stat. 3342.

greater than those of a general creditor.”<sup>155</sup> Thus, a structured settlement recipient was merely a “general creditor”<sup>156</sup> to a structured settlement company, a person to whom the company owed future payments. However, Congress changed the language in 1988 to state, “The determination . . . of when the recipient is treated as having received any payment with respect to which there has been a qualified assignment shall be made without regard to any provision of such assignment which grants the recipient rights as a creditor greater than those of a general creditor.”<sup>157</sup> Thus, structured settlement plaintiffs can now obtain rights “greater than those of a general creditor.”<sup>158</sup>

The new language in the 1988 amendment has been read by the IRS to override the doctrine of economic benefit:

Generally, the setting aside of funds in trust for recipient confers an economic benefit and results in income to the recipient in the year of setting aside the funds. *See Sproull v. Commissioner*, 16 T.C. 244 (1951), *aff’d per curiam*, 194 F.2d 541 (6th Cir. 1952). However, the 1988 amendment to section 130(c) of the Code was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments.<sup>159</sup>

The IRS has since held that a plaintiff can hold a security interest in a bank trust created by defendant to fund plaintiff’s periodic payments without violating sections 104(a)(2) or 130.<sup>160</sup> Today, some insurance companies offer agreements providing these greater rights, while others do not.<sup>161</sup>

As an explanation for the 1988 amendment, the House Report stated, “Recipients of periodic payments under structured settlement arrangements should not have their rights as creditors limited by provisions of tax law.”<sup>162</sup> Thus, perhaps meaning to, or perhaps not,

155. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(c)(2)(C), 96 Stat. 2605.

156. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605.

157. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342.

158. *Id.*

159. I.R.S. Priv. Ltr. Rul. 97-03-038 (Jan. 1, 1997) (emphasis added).

160. *Id.*; *see also* I.R.S. Priv. Ltr. Rul. 92-53-045 (Oct. 6, 1992) (holding that section 130 allows a plaintiff to perfect a security interest in a structured settlement annuity contract).

161. E-mail from Betty Gregware, Sales Executive, John Hancock Life Insurance Company to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 27, 2009, 12:47:07 EST) (on file with author).

162. H.R. REP. NO. 100-795, at 541 (1988). *See generally* H.R. REP. NO. 100-1104, at 25 (1988) (Conf. Rep.).

Congress took a large step away from the economic benefit doctrine as it applies to structured settlements.

Commentators vary in their interpretation of the 1988 switch. One author simply finds the failure to apply the economic benefit doctrine to periodic payments confusing, especially in light of contradictory application of the doctrine in analogous contexts.<sup>163</sup> Another argues that the doctrines of constructive receipt and economic benefit, as applied to structured settlements, should be narrowly construed.<sup>164</sup> At the very least, the 1988 amendment to section 130 allowed the payee of a structured settlement rights that the 1982 House<sup>165</sup> and Senate<sup>166</sup> reports stated would render the received payments ineligible for the favored tax treatment, thus violating the traditional understanding of the economic benefit doctrine.

However, the 1988 legislation did not necessarily contravene Congress's purpose in creating the structured settlement tax subsidy. The new rights available under the amendment can only be accessed under rare circumstances that, in fact, have never transpired.<sup>167</sup> If anything, the amendment assists the tax subsidy, encouraging personal injury claimants to engage in structured settlements by reducing the fear of losing one's settlement monies due to a defendant's bankruptcy. For purposes of this Article the important takeaway is that even early on Congress showed a willingness to relax the doctrine of economic benefit as applied to structured settlements.

### *B. Eroding Constructive Receipt Through Factoring*

Though the 1988 amendment marked a departure from the original application of the economic benefit doctrine to structured settlements, a new transaction developed in the early 1990s that went even further, violating the traditional understanding of the constructive receipt doctrine.<sup>168</sup> The transaction, known as structured settlement

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163. Frolik, *supra* note 55, at 581–82 (citing Rev. Rul. 62-74, 1962-1 C.B. 68 (holding prize payments that would be paid out over two years to be taxable in the year won, despite the fact that the prize money had been deposited into an escrow account prior to the contest); *Pulsifier v. Comm'r*, 64 T.C. 245, 245–47 (1975) (holding a cash prize taxable in the year won, though it would not be received by the minor winners until the age of majority)). Frolik argues that it seems far more plausible to apply the economic benefit doctrine to structured settlements than prizes not immediately redeemable, especially since structured settlement recipients often play a role in creating the terms and timing of the future payments. Frolik, *supra* note 55, at 581–582.

164. Risk, *A Case*, *supra* note 7, at 652.

165. See H.R. REP. NO. 97-832, at 4 (1982).

166. See S. REP. NO. 97-646, at 4 (1982).

167. Gregware Interview, *supra* note 17.

168. Scales, *supra* note 2, at 915.

“factoring,” is the sale by a former claimant, now payee, of the right to their structured settlement’s future stream of income<sup>169</sup> in exchange for a lump-sum payment.<sup>170</sup> The payee’s received lump-sum has since been held to fall under section 104(a)(2), just as if paid in lump-sum form by the original defendant.<sup>171</sup> By offering a cash amount to a structured settlement recipient sufficiently below the present value of the future income stream, a factoring company<sup>172</sup> can net a profit. Commentators have observed that plaintiffs’ newfound ability to convert their future structured settlement payments to present value at any time “bespeak[s] ‘constructive receipt’ of those payments.”<sup>173</sup> Thus, in the early 1990s, the creation of the factoring industry tread over

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169. The factoring industry reports that the vast majority of factoring transactions are partial purchases, performed by employed structured settlement owners long after the original settlement. *1999 Hearing*, *supra* note 15, at 19–20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, LLP, on behalf of the NASP) (noting that the average seller of a structured settlement had a household income of nearly \$25,000).

170. Scales, *supra* note 2, at 861 (also referring to factoring as “unstructuring”). Insurance companies selling structured settlement annuities frequently place anti-assignment clauses in their contracts. Gregory S. Crespi, *Selling Structured Settlements: The Uncertain Effect of Anti-Assignment Clauses*, 28 PEPP. L. REV. 787, 789 (2001). Anti-assignment clauses are typically not self-executing. Hindert E-mail, Sept. 4, 2009, *supra* note 45. A relevant party must act to enforce the clause, though this has become rare since the insertion of section 5891 into the Tax Code. *Id.* An evolving area of law is the question of whether or not such clauses are effective. *See generally* HINDERT ET AL., *supra* note 90, § 16.02[c]; Crespi, *supra*. However, some observe that anti-assignment clauses are generally not enforced today. *See* Hindert & Ulman, *supra* note 102; *see* Patrick D. Dolan, *Securitization of Life Settlements, Structured Settlements and Lottery Awards*, in NEW DEVELOPMENTS IN SECURITIZATION 2008 961, 967 (2008) (“Although State Transfer Acts do not explicitly address the enforceability of anti-assignment clauses, the procedures make it much less likely that the transfer will be attacked successfully.”). *But see* *C.U. Annuity Service Corp. v. Young*, 722 N.Y.S.2d 236, 236–37 (N.Y. App. Div. 2001) (“[T]he promisee did not merely agree that he would refrain from making an assignment; he agreed he was powerless to do so. Having surrendered his legal ability to assign, there was no basis upon which he or any assignee could assert that a purported sale could have any legal effect.”); HINDERT ET AL., *supra* note 90, § 16.02[2] (“[I]n the vast majority of cases, the courts have enforced anti-assignment provisions in structured settlement agreements.”). In 1999, it was reported that the insurance industry “routinely file[d] 40 and 50 page briefs and objections to the transfers.” *1999 Hearing*, *supra* note 15, at 24 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

171. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999).

172. Though structured settlement recipients typically sell their future stream of income to factoring companies, they could also sell the stream to the original structured settlement company or life insurance company. *See* *Settlement Capital Corp. v. BHG Structured Settlements, Inc.*, 319 F. Supp. 2d 729, 732 (N.D. Tex. 2004) (concerning a tortious claim where a factoring company lost a purchase of periodic payments from a structured settlement recipient, who decided to transfer her future payments to the annuity-originating structured settlement company instead of the factoring company).

173. Scales, *supra* note 2, at 915.

Congress's original understanding of section 104(a)(2)'s exclusion limitations.

The factoring market began in the early 1990s.<sup>174</sup> The Settlement Capital Corporation describes itself as the first factoring company.<sup>175</sup> Jim Lokey, the corporation's founder, created the business model after responding to a structured settlement recipient's classified advertisement in a local paper, offering to sell the right to future payments.<sup>176</sup> Soon, other companies entered the market, such as J.G. Wentworth, Peachtree Funding, and Singer Asset Finance.<sup>177</sup> By 1997, at least five major settlement purchasers and many small brokers joined the fray.<sup>178</sup> By 2005, it was estimated that some \$250 million of structured settlement payments were purchased annually.<sup>179</sup> J.G. Wentworth, the self-proclaimed "leading direct-to-consumer purchaser of illiquid insurance products issued by highly rated financial institutions in the United States,"<sup>180</sup> reports purchasing structured settlements with aggregate payment streams of \$728 million in both 2007 and 2008.<sup>181</sup> Since its inception, the company has completed over 51,000 factoring transactions, with aggregate payment streams of nearly \$4 billion.<sup>182</sup> Currently, it is estimated that approximately 8,000 factoring transactions occur annually, with an average price of \$45,000, amounting to \$360 million.<sup>183</sup> Based on the estimated value

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174. Mannix, *supra* note 27, at 62; O'Connell, *supra* note 27. *But see* Settlement Capital Corporation, Structured Settlement Factoring, [http://www.setcap.com/structuredfactoring.aspx?pt=services&mCATEGORY\\_ID=84&SubCATEGORY\\_ID=84](http://www.setcap.com/structuredfactoring.aspx?pt=services&mCATEGORY_ID=84&SubCATEGORY_ID=84) (last visited Feb. 19, 2010).

175. Settlement Capital Corporation, *supra* note 174.

176. Scales, *supra* note 2, at 898 (citing Interview with Earl Nesbitt, Vice President and General Counsel, Settlement Capital Co., in Halladale, Fla. (Oct. 29, 2001)).

177. Scales, *supra* note 2, at 900. To expand his business, Lokey encouraged structured settlement insurers, consultants, and brokers to refer clients in need of upfront cash to Settlement Capital Corp. Bracy Interview, *supra* note 28. In doing so, he taught his soon-to-be competitors how to factor. *Id.*

178. HINDERT ET AL., *supra* note 90, § 16.02[1] (citing *Selling Structured Settlement Payments*, NSSTA Newsletter, 3 (Jan. 1998)). Other companies, such as Berkshire Hathaway Life Insurance Co., later entered the market. Mannix, *supra* note 27, at 62. Though there used to be a great many brokers, they are now few and far between. Bracy Interview, *supra* note 28. Many of the factoring brokerage companies are now factoring companies. *Id.*

179. *See* HINDERT ET AL., *supra* note 90, § 16.02[2].

180. Disclosure Statement: Prepetition Solicitation of Votes with Respect to Prepackaged Plan of Reorganization for JGW Holdco, LLC, J.G. Wentworth, LLC and J.G. Wentworth, Inc. 14 (2009) [hereinafter J.G. Wentworth Disclosure Statement].

181. *Id.* at 15.

182. *Id.*

183. E-mail from Earl Nesbitt, Executive Director, NASP, Sept. 11, 2009 to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (on file

of all structured settlements, it is believed that between 5% and 8% of all structured settlements are eventually factored.<sup>184</sup>

Today, a factoring transfer is typically complete three months after a structured settlement recipient first makes contact with the factoring company.<sup>185</sup> Some companies advertise that money can be transferred to recipients within three to six weeks, and even offer cash advances within a few days.<sup>186</sup> Factorers have represented that 88% of structured settlement purchases are “partial purchases,”<sup>187</sup> such that the claimant only sells a portion of his or her future income stream, though J.G. Wentworth has stated that the average factoring customer completes an average of more than two such transactions.<sup>188</sup> According to J.G. Wentworth’s<sup>189</sup> Chief Marketing Officer, over 70% of surveyed structured settlement sellers owned their structured settlement for over ten years before factoring.<sup>190</sup>

The factoring market has also fed into securities.<sup>191</sup> In 1997, J.G. Wentworth sold over \$140 million of structured settlement securities, paying as much as 7.8% interest per year.<sup>192</sup> Since then, the company has completed nineteen securitizations totaling approximately \$2.1 billion.<sup>193</sup> The practice has continued during the 2008 credit crisis,<sup>194</sup> which has been both a boon and a drought to the factoring industry.<sup>195</sup> The reduced availability of credit has driven up business costs, while the downturn has increased consumer demand.<sup>196</sup>

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with author) [hereinafter Nesbitt E-mail, Sept. 11, 2009] (estimating lower numbers for 2009).

184. *Id.*

185. Bracy Interview, *supra* note 28.

186. *E.g.*, Seneca One, Getting Started, <http://www.senecaone.com/structured-settlement-recipients/getting-started.aspx> (last visited Mar. 17, 2009).

187. 1999 Hearing, *supra* note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers); Telephone Interview with Andrew Cravenho, CEO, Settlement Quotes LLC (Feb. 19, 2009) [hereinafter Cravenho Interview] (stating that structured settlement purchases are typically for most of the guaranteed portion of a structured settlement).

188. J.G. Wentworth Disclosure Statement, *supra* note 180, at 15.

189. Bracy Interview, *supra* note 28 (indicating that J.G. Wentworth and Peachtree are, by far, the largest factoring companies in the industry).

190. The #1 Reason, *supra* note 18 (citing Ken Murray, J.G. Wentworth’s Chief Marketing Officer).

191. Andrada, *supra* note 36, at 472 (citing O’Connell, *supra* note 27, at A8).

192. O’Connell, *supra* note 27, at A8.

193. J.G. Wentworth Disclosure Statement, *supra* note 180, at 23.

194. See J.G. Wentworth – 2, [http://s2kmblog.typepad.com/rethinking\\_structured\\_set/2008/12/jg-wentworth-2.html](http://s2kmblog.typepad.com/rethinking_structured_set/2008/12/jg-wentworth-2.html) (last visited Feb. 6, 2009).

195. See generally J.G. Wentworth Disclosure Statement, *supra* note 180.

196. Bracy Interview, *supra* note 28; Cravenho Interview, *supra* note 187.

C. *The IRS Extends the Section 104(a)(2) Exclusion to Factoring Transactions*

In 1999, the IRS formally eroded the constructive receipt doctrine as applied to structured settlements. That year, the IRS held the section 104(a)(2) tax exclusion to apply to monies received by structured settlement recipients for selling their future payments.<sup>197</sup>

The IRS looked back to their earliest structured settlement ruling,<sup>198</sup> noting that the periodic payments were excluded because “the individual had a right to receive only the monthly payments and *did not have the actual or constructive receipt or the economic benefit of the lump-sum amount.*”<sup>199</sup> However, the 1999 ruling held a factoring company’s lump-sum payment to claimant to be of the same “character under §104(a)(2)”<sup>200</sup> as the future payments that claimant would have otherwise received, and therefore excludible.<sup>201</sup>

The 1999 ruling stands in stark contrast to the earlier 1979 ruling, as well as Congress’s statements in 1982: “the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer *is not in constructive receipt of or does not have the current economic benefit* of the sum required to produce the periodic payments.”<sup>202</sup> The IRS’s treatment of the proceeds from the factoring transaction portrays structured settlement payments as a secure and alienable asset. But if secure and alienable, it follows that a structured settlement constitutes a constructive receipt of the future stream of income.

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197. See I.R.S. Priv. Ltr. Rul. 1999-36-030 (Sept. 10, 1999); see also Andrada, *supra* note 36, at 483–84. See generally I.R.S. Priv. Ltr. Rul. 96-39-016 (June 17, 1996) (holding a lottery winner’s ability to assign rights to future payments not to constitute constructive receipt).

198. See Rev. Rul. 79-220, 1979-2 C.B. 74.

199. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (emphasis added) (citing Rev. Rul. 79-220, 1979-2 C.B. 74).

200. *Id.*

201. See *id.* (declining to decide whether the transaction affected the structured settlement company making the future payments under section 130); see also Andrada, *supra* note 36, at 487 (noting substantial disagreement regarding the application of section 130 to this scenario prior to the enactment of 2001 legislation). Compare I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (citing *Ennis v. Comm’r*, 17 T.C. 465 (1951)) (observing that transferred assets are taxable if they are “the equivalent of cash . . . [being] *commonly sold* or given as a part of a purchase price) (emphasis added), and Rev. Rul. 68-606, 1968-2 C.B. 42 (cited as a limiting case), with I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999) (explaining that the factoring transaction had become common by 1999 and holding that the structured settlement “was not readily saleable,” and thus not equivalent to cash).

202. H.R. REP. NO. 97-832, at 4 (1982) (emphasis added); S. REP. NO. 97-646, at 4 (1982) (emphasis added).

Of course, the IRS did not rule on the legality of the transaction, merely on the proceeds' taxability. The legality of the transaction, or at least the implied legality, would be legislated just a few years later.

*D. Federal and State Legislatures Pass Laws Implicitly  
Approving Factoring*

Because of the uncertainty of factoring transactions' impact on the original structured settlement selling company, the insurance industry lobbied against structured settlement purchasing.<sup>203</sup> In fact, NSSTA spent over \$1.25 million on lobbying from 1998 through 2001.<sup>204</sup> On the other side,<sup>205</sup> the factoring industry, through its political persona of NASP<sup>206</sup> lobbied to oppose restrictions on settlement purchasing.<sup>207</sup> Naturally, the two sides criticized each other publicly.<sup>208</sup>

Those in Congress and at the Treasury viewed factoring as a contravention of the structured settlement tax subsidy's purpose.<sup>209</sup> As a

203. Risk, *Structured Settlements*, *supra* note 19, at 883.

204. OpenSecrets.org, Annual Lobbying by National Structured Settlements Trade Association, <http://www.opensecrets.org/lobby/clientsum.php?lname=Natl+Structured+Settlements+Trade+Assn&year=2009> (last visited Nov. 14, 2009); *see* Bracy Interview, *supra* note 28 (stating that the insurance industry "went to war with us, full out, no holds barred war—their purpose was to put us out of business" and indicating that the insurance industry sued factoring companies in state courts for interfering with insurance company contracts, and lobbied state legislatures to outlaw factoring transactions).

205. *See generally* HINDERT ET AL., *supra* note 90, § 16.01[3] ("a federal and state legislative contest ensued between those favoring and opposed to factoring structured settlements").

206. NASP is an acronym for the National Association of Settlement Purchasers.

207. Risk, *Structured Settlements*, *supra* note 19, at 884; Dyer Interview, *supra* note 53 ("Both sides spent huge sums of money in an effort to overwhelm the other side."). *But see* Bracy Interview, *supra* note 28 ("The view that [section 5891 and state structured settlement protection acts] were designed to punish the factoring industry is ridiculous. It was [the purchasing companies] who made the overwhelming effort to get them approved.").

208. Some of their criticisms will be referred to later in the Article, as they allegedly provide inside information.

209. 1999 *Hearing*, *supra* note 15, at 6 (statement of Rep. E. Clay Shaw, Jr.) ("The integrity of the entire system is being undone by factoring transactions . . . leaving [former plaintiffs] in the very predicament that structured settlements were set up to avoid."); *id.* (written statement of Rep. Pete Stark) (stating that factoring "completely frustrates what our Committee intended when it adopted the original legislation to encourage structured settlements"); *id.* at 12 (written statement of Joseph M. Mikrut, Tax Legislative Counsel, Department of Treasury) ("These factoring transactions directly undermine the policy objective underlying the structured settlement tax regime, that of protecting the long-term financial needs of injured persons. The factoring transactions also effectively contravene the statutory requirement conditioning favorable tax treatment to the various parties to the arrangement on the injured per-

legislative response to factoring, Senator Baucus recommended a penalty tax on factoring transactions except in court-approved cases in “instances of true hardship of the victim.”<sup>210</sup> This legislation, proposed in 1998, would have set a very high standard of hardship.<sup>211</sup> Under the proposal, a court or administrative body would have had to find that “the extraordinary, unanticipated, and imminent needs of the structured settlement recipient or the recipient’s spouse or depends render such a transfer appropriate.”<sup>212</sup> Such language would likely have resulted in a severe decline in factoring transactions. Others recommended more lenient standards of court approval,<sup>213</sup> such as a best interests standard.<sup>214</sup> Soon after, the insurance and factoring industries agreed to a compromise,<sup>215</sup> proposing a law imposing a 40% excise tax on settlement purchase transactions without court approval.<sup>216</sup>

“Creatively attached”<sup>217</sup> to the Victims of Terrorism Tax Relief Act of 2001,<sup>218</sup> Congress passed the proposed legislation. The Act created section 5891, providing an excise tax of 40% for factoring

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son’s inability to accelerate such payments.”); 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus) (“I now find that all of this careful planning and long-term financial security for the victim and his or her family can be unraveled in an instant by a factoring company offering quick cash at a steep discount. . . . These structured settlement factoring transactions place the injured victim in the very predicament that the structured settlement was intended to avoid.”).

210. 144 CONG. REC. S11,499-01 (1998) (statement of Sen. Baucus); Dyer Interview, *supra* note 53 (noting that NSSTA lobbied for a standard of financial hardship before 2000).

211. See Structured Settlement Protection Act, H.R. 4314, 105th Cong. (2d Sess.) § 5891(b)(2) (1998).

212. *Id.*

213. See Andrada, *supra* note 36, at 494.

214. 1999 Hearing, *supra* note 15, at 24 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (“The court should be asking, ‘what is in the best interest of the claimant?’”).

215. HINDERT ET AL., *supra* note 90, § 8A.03[1].

216. Risk, *Structured Settlements*, *supra* note 19, at 884 (citing Letter from NSSTA to Hon. Bill Archer and Hon. William V. Roth, Jr., chairmen of U.S. House Ways and Means Committee and Senate Finance Committee (Sept. 13, 2000)). While the factoring industry did not readily accept the court approval process, some thought that it would also benefit factoring companies because the legislation and court approvals would legitimize and secure each transaction. Bracy Interview, *supra* note 28. Interestingly, though Republicans are typically found on the side of insurance companies, this was not so with respect to section 5891. Because of the Republican ethic of economic liberalism, many Republican congressmen disliked the idea of requiring payees to seek court approval for factoring transactions. In fact, though NASP eventually agreed to the court approval process under the best interests standards, some Republicans still disapproved. *Id.*

217. Scales, *supra* note 2, at 918.

218. See Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002).

transactions not approved by a “qualified order,”<sup>219</sup> to be made by an applicable State Court or administrative authority finding the transaction to be in “the best interests of payee.”<sup>220</sup> A House report described section 5891 as “[p]rotecting victims who sell structured settlements for a lump sum,”<sup>221</sup> though, as one commentator notes, “the legislation said remarkably little about the now much weakened and nebulous standard that required the factoring transaction.”<sup>222</sup> More than simply enacting the excise tax for transactions not approved by courts, the Act also “retroactively immuniz[ed previous] factoring transactions from tax challenges.”<sup>223</sup>

Though previous Congressional statements may have suggested antipathy for factoring, and though section 5891 punishes factoring transactions without court approval,<sup>224</sup> the legislation seems to implicitly approve of factoring under certain conditions.<sup>225</sup> NSSTA<sup>226</sup> and

219. I.R.C. § 5891(b)(1) (2006).

220. I.R.C. § 5891(b)(2)(A)(ii) (2006). *See generally* HINDERT ET AL., *supra* note 90, § 16.05[4].

221. H.R. REP. NO. 107-801, at 5 (2003).

222. Koenig, *supra* note 2 at 818.

223. Scales, *supra* note 2, at 918 (citing Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002)).

224. *See* I.R.C. § 5891 (2006).

225. *See* HINDERT ET AL., *supra* note 90, § 16.03[3][a][i] (“The Victims of Terrorism Tax Relief Act recognizes that unanticipated circumstances, in some cases, justify a transfer of structured settlement payment rights.”); Richard Risk, Jr., *Attorney Comments on Forthcoming Guidance on Use of Qualified Settlement Funds for Benefit of Single Claimant*, 2008 TAX NOTES 30-19, Feb. 28, 2008 [hereinafter Risk, *Attorney Comments*] (“Since 2002, the payee has a right under *Section 5891* to sell future payments, with advance written approval from a state court.”); E-mail from Betty Gregware, Sales Executive, John Hancock Life Insurance Company to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 31, 2009, 1:48:48 EST) (on file with author) (“Federal statute 5891 does implicitly approve factoring through directing individuals to the state specific Periodic Payment Protection Act statues [sic] for the requirements regarding how to change their periodic payments, which include court approval.”); E-mail from Earl Nesbitt, Executive Director, NASP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (June 19, 2009) (on file with author) [hereinafter Nesbitt E-mail, June 19, 2009] (“Congress and 46 states would not have created laws specifically governing the sale of structured settlement payment rights if they did not want the sales to happen. The fact that they legislated in the area shows that they approve.”); Settlement Capital Corporation, Structured Settlements, <http://www.setcap.com/education-structuredsettlements.aspx?pt=education> (last visited Feb. 19, 2010) (“The passing of . . . IRC 5891 was monumental in establishing our industry’s credibility. This law validated our industry and helps plaintiffs gain access to their structured settlement annuity payments. It also clarified that transfer sales are completely tax-free for both the annuitants and the annuity providers.”). By passing legislation penalizing only *unapproved* factoring transactions, Congress’s legislation tends to show some degree of approval, at least implicitly.

many others<sup>227</sup> firmly disagree with this view.<sup>228</sup> However, states have shown a desire to allow factoring transactions by passing “transfer acts”<sup>229</sup> giving their courts the power to approve the transactions, thus triggering the section 5891 exemption. Currently, forty-seven states have transfer laws, providing courts the ability to approve transfers under varying guidelines.<sup>230</sup> State courts have been handling

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226. NSSTA’s counsel maintains that factoring is “fundamentally incompatible with the purposes that structured settlements are intended to serve.” Ulman E-mail, Feb. 16, 2009, *supra* note 39 (noting there might be a very few cases in which factoring would make sense). Ulman takes exception to the argument that the passage of section 5891 somehow implicitly approved of factoring; “To read that as implied approval of factoring is doing a grave disservice to those who passed the law.” *Id.* Asked why Congress did not go further in establishing a barrier to factoring transactions, counsel responds, “Factoring companies are capable of lobbying just as much as anyone else. Section 5891 is the result of legislative compromise.” *Id.*

227. At least one court has held that section 5891 “does not establish a statutory right for such transfers.” *Continental Casualty v. United States*, No. C 02-4891 VRW, C 02-5292 VRW, 2006 WL 3455055, at \*2 (N.D. Cal. Nov. 29, 2006) (amended order) (rejecting an argument that a settlement’s anti-assignment clause destroys the congressionally created right to factor). In addition, some call the implicit approval assertion “propaganda and misinformation.” E-mail from John Darer, President, 4structures.com. LLC, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 26, 2009, 2:30:31 EST) (on file with author) [hereinafter Darer Interview]. Darer argues that section 5891 was legislated “to levy an excise tax to cure abuses in prior years and state exceptions to such a tax.” *Id.* He cites to *United States v. Testan*, a United States Supreme Court case holding that the legislation of a jurisdictional statute did not simultaneously create a substantive right. 424 U.S. 392, 398 (1976). Thus, section 5891, legislating an excise tax, may not have simultaneously created the substantive right to factor. It should be noted that *Testan* was a suit against the United States. Because no right to money damages against the United States can exist without a waiver of sovereign immunity, the standard to establish the granting of a right of action may have been higher. *See id.* at 400–01.

228. The arguments for and against allowing factoring are elaborated upon in the next sub-section.

229. Scales, *supra* note 2, at 921. These are commonly called Structured Settlement Protection Acts. HINDERT ET AL., *supra* note 90, § 16.04[1] (providing a table of the various state statutes).

230. HINDERT ET AL., *supra* note 90, § 16.04[1] (not yet accounting for North Dakota’s statute, N.D. CENT. CODE §§ 32-03.4-01 to -13 (Supp. 2009)); Structured Settlement Corporation, *supra* note 225. In 2000, the insurance and factoring industries worked together, Patrick Hindert, *Structured Settlements in 2008—3*, BEYOND STRUCTURED SETTLEMENTS, Jan. 31, 2009, [http://s2kmblog.typepad.com/rethinking\\_structured\\_set/2008/12/structured-settlements-in-2008-3.html](http://s2kmblog.typepad.com/rethinking_structured_set/2008/12/structured-settlements-in-2008-3.html), to establish a Model State Structured Settlement Protection Act. The Act was later supported by the National Conference of Insurance Legislators. *Id.* In the states without protection acts, factoring transactions can still occur. I.R.C. § 5891(b)(2)(B) (2006) (allowing a transfer using the act from the state of the factoring company or life insurance company that issued the structured settlement annuity). Factoring companies do purchase structured settlements in those states. Bracy Interview, *supra* note 28. Bracy says that the NASP hired lobbyists in almost every state to encourage the legislation of structured settlement protection acts. *Id.* Of course, this is probably because without those acts, as a result of the newly legislated section 5891, all factoring transactions would face

factoring cases ever since.<sup>231</sup>

Different states have passed differing transfer acts.<sup>232</sup> Some, for example, require the additional finding that the transfer is “fair and reasonable,”<sup>233</sup> in addition to being in the best interests of the payee. Some courts,<sup>234</sup> and in fact some statutes,<sup>235</sup> refuse to approve transfers in excess of certain discount rates. In the end, however, it is well established that the core of a best interest test is judicial discretion.<sup>236</sup> Different judges scrutinize the applicable laws with different focuses.<sup>237</sup> However, this does not mean that state courts infrequently approve factoring transactions. Many in the factoring industry report application approvals of 95% or higher.<sup>238</sup> Moreover, even when

the 40% excise tax. However, a Former Executive Vice President of NSSTA says that all but one of the forty-six structured settlement protection acts resulted from NSSTA work. Dyer Interview, *supra* note 53.

231. See generally 321 Henderson Receivables, L.P., v. Martinez, 816 N.Y.S.2d 298 (Sup. Ct. 2006); *In re Settlement Capital Cor.*, 769 N.Y.S.2d 817 (Sup. Ct. 2003); *Settlement Capital Corp. v. State Farm Mut. Auto. Ins. Co.*, 646 N.W.2d 550 (Minn. Ct. App. 2002).

232. Hindert & Ulman, *supra* note 102, at 19. At least one factoring company has repeatedly attempted “to circumvent state structured settlement protection acts and bind settlement obligors and annuity issuers to arbitrations.” *Allstate Settlement Corp. v. Rapid Settlements, Ltd.*, 559 F.3d 164, 172 (3d Cir. 2009).

233. Hindert & Ulman, *supra* note 102, at 22.

234. See *In re Settlement Capital Cor.*, 769 N.Y.S.2d 817, 829 (Sup. Ct. 2003).

235. E.g., N.C. GEN. STAT. ANN. § 1-543.12(6) (West 2000).

236. Hindert & Ulman, *supra* note 102, at 22 (citing *In re Settlement Capital Cor.*, 769 N.Y.S.2d 817 (Sup. Ct. 2003)); Interview with Jane Solomon, Supreme Court Justice, New York State Supreme Court, in New York, NY (Jan. 3, 2009) [hereinafter Solomon Interview] (citing broad discretion).

237. Solomon Interview, *supra* note 236. As counsel for the NSSTA observed, “The ‘best interest’ standard under state structured settlement protection acts is as stringent, or as lax as judges choose to make it.” Ulman E-mail, Feb. 16, 2009, *supra* note 39; see also HINDERT ET AL., *supra* note 90, § 8A.04[3] (“In practice, the review of an application for authorization varies greatly with the disposition of the assigned judge.”); Nesbitt E-mail, June 19, 2009, *supra* note 225 (observing, that “[a]t the end of the day, it’s the judge,” and that there is at least one judge in Texas who has said that he will never approve a transfer, regardless of the circumstances).

238. Milton & Dekruif, Firm Profile, <http://www.lawyers.com/California/Glendale/Milton-and-DeKruif-3024685-f.html> (last visited Feb. 18, 2010) (reporting a 98% approval rate in over 3,000 transfers); Bracy Interview, *supra* note 28 (reporting a rate above 95%); Solomon Interview, *supra* note 236 (reporting approving 75% of applications in 2007). The statistics may be inflated by the fact that applications are sometimes withdrawn. Ulman E-mail, Feb. 16, 2009, *supra* note 39. It is unclear how many potential purchases factoring companies turn down in order to maintain these high approval rates, though it is substantial. Bracy Interview, *supra* note 28; see Cravenho Interview, *supra* note 187 (noting that applications that are likely to be denied are not likely to be made). One broker in the factoring industry reports never having a settlement purchase sale application rejected. *Id.* (also reporting that at least one company maintains a rejection rate of less than half of one percent). Factoring companies work to push their approval rate as high as possible for two reasons. First,

one's application is denied, a structured settlement owner can typically re-apply without a waiting period, or disclosing the previous denial to the subsequent court.<sup>239</sup> The Pennsylvania Supreme Court has required such disclosure through its rules of civil procedure,<sup>240</sup> and calls have been made for at least one other state's supreme court to do so.<sup>241</sup> Given that the factoring industry currently purchases over \$200 million of structured settlements each year, that is hardly surprising.<sup>242</sup>

*E. Should Structured Settlement Recipients Be Allowed to Factor?*

When considering whether to utilize a structured settlement, claimants will often know of their later ability to factor. In fact, some structured settlement planners always discuss the option with their clients.<sup>243</sup> One such planner calls it a "clear benefit"<sup>244</sup> to his clients, many of whom would not otherwise accept a structured settlement.<sup>245</sup>

An author once likened a plaintiff's decision to delay receiving much of a settlement to the Odyssey's Ulysses binding himself to the mast of his ship so as to prevent his future self from abandoning the vessel and swimming to the Siren's fatal shores.<sup>246</sup> The author comi-

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they typically pay for the application process. These range between \$2,000 and \$2,500. Bracy Interview, *supra* note 28; Cravenho Interview, *supra* note 187 (reporting transaction costs of between \$3,000 and \$4,000); 1999 Hearing (statement of Timothy J. Frankina, Founder and CEO of Peachtree Settlement Funding) (reporting that seeking court approval for a structured settlement could "easily cost the consumer 10% or more . . . in attorney's fees and court costs"). Second, each rejection might have negative consequences. Some like to say that factoring companies have two "customers: the real customer and the judge." Bracy Interview, *supra* note 28. Both must approve the transfer. *Id.* Some in the industry predict that the best interests standard will become more strict as judges become more familiar with it. Ulman E-mail, Feb. 16, 2009, *supra* note 39.

239. Edward O. Burke, *Structured Settlement Factoring*, 44 ARIZ. ATT'Y 23, 30 (2008) (noting that at least one judge has ordered factoring companies to disclose previous applications).

240. See PA. R. CIV. P. 229.2 (f) (2007).

241. Burke, *supra* note 239, at 30 (discussing Arizona). The author agrees with such calls.

242. Cravenho Interview, *supra* note 187. In 2007, one judge reported approving 75% of all factoring transaction applications. Solomon Interview, *supra* note 236.

243. Meligan Interview, *supra* note 31. One leading commentator suggests that while some structured settlement advisors will provide advice about factoring, most do not have the knowledge to do so. Hindert E-mail, Sept. 4, 2009, *supra* note 45.

244. Meligan Interview, *supra* note 31.

245. *Id.*

246. Smith, *supra* note 56, at 1969–70 (citing JON ELSTER, ULYSSES AND THE SIRENS: STUDIES IN RATIONALITY AND IRRATIONALITY 1-111 (rev. ed. 1984)). See generally THE ODYSSEY OF HOMER 242–43 (Allen Mandelbaum trans., Bantam Classics 1990) ("I sealed the ears of my crew in turn. That done, they bound my hands and feet, as I stood upright on the mast box; and they tied the ropes hard fast around the

cally noted, “The difference between Ulysses and the plaintiff in the structured settlement is that, so far as we know, Ulysses did not get a tax break to encourage being bound.”<sup>247</sup> Actually, as of the early 1990s, there is another key difference; Ulysses could not untie himself for a given price.

This section describes the reasons for and against allowing structured settlement recipients to factor. The strongest argument for allowing factoring is that persons should be able to respond to changed circumstances. In opposition, however, one must consider the purpose of binding one’s future self, and the costs of unbinding.<sup>248</sup> The Article then considers whether allowing factoring renders the tax subsidy ineffective at accomplishing its purpose of discouraging premature dissipation, finding that factoring may strengthen the subsidy’s effectiveness.

### 1. *The Right to Factor*

No one can predict the future. Though structured settlements encourage one to delay receiving monies so as to protect one’s future interest, they also force a claimant to make decisions about how much money he or she will need, and when,<sup>249</sup> often long before such knowledge is available. Thus, the pre-arranged payments likely will not accurately anticipate a claimant’s future needs.<sup>250</sup> Where a structured settlement owner, because of such unexpected needs, wishes to make use of their future payments, it would not make sense to prevent them from doing so. Of course, the definition of “unexpected” becomes the central variable in that argument. Through the 1999 legislation, Congress left that decision to the judgment of courts.<sup>251</sup>

One could also argue that Congress should allow factoring to counteract plaintiff attorneys’ perverse incentive to inadequately re-

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mast . . . . My heart longed so to listen, and I asked my men to set me free . . . . But when we’d passed beyond the Sirens’ isle . . . [t]hey freed me from my mast.”)

247. Smith, *supra* note 56, at 1969–70 (citing ELSTER, *supra* note 246, at 1-111).

248. Historically, there have also been accusations that the factoring industry used “abusive tactics against the disabled.” Randy Dyer, Letter to the Editor, *Structured Settlements Need Watchful Eye*, N.Y.L.J., Oct. 21, 1999, at 2 (Executive Vice President of National Structured Settlements Trade Association). At least some factoring companies circumvented anti-assignment clauses by directing plaintiff to send a change-of-address notice to the structured settlement company making the periodic payments, and then sign over power-of-attorney privileges to the factoring company, allowing the periodic payments to be deposited by the factoring company. I.R.S. Priv. Ltr. Rul. 1999-36-030 (June 10, 1999).

249. See Luther, *supra* note 42, at 30.

250. Andrada, *supra* note 36, at 477.

251. See I.R.C. § 5891 (2006).

present their clients. One author argues that such attorneys may not spend the necessary time to accurately design a structured settlement payment schedule because they operate on a contingency fee basis.<sup>252</sup> So long as the present value of the settlement remains the same, a contingency fee of 30% will produce the same payment whether the payment schedule accurately predicts a clients' needs or not. Thus, the ability to escape the structured settlement plan may compensate for incentivized attorney misrepresentation.

These arguments suggest that Congress should allow factoring, at least sometimes. In addition, positive notions of alienability favor the right to factor. While it is beyond the scope of this Article, some support for claimants' alienability of their future structured settlement payments can be found in the Uniform Commercial Code Revised Article 9,<sup>253</sup> which "has a general purpose of promoting commerce by allowing the pledging and other assignment of payment rights in order to facilitate credit transactions."<sup>254</sup> Evidence for such a position can be found in several sections of the Code's 1999 Revision,<sup>255</sup> and factoring companies have frequently cited Article 9 in asking courts to

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252. Andrada, *supra* note 36, at 477.

253. PAUL J. LESTI, *STRUCTURED SETTLEMENTS* § 19:11.1. (2d ed. 2008) ("If a state passes the revision to Article 9 of the U.C.C. in its current proposed form, it appears that factoring transactions will be allowed under that state's U.C.C. However, many states that have passed or considered this revision to their state's U.C.C. law have amended it to prevent a person from factoring their rights under structured settlement, workers' compensation and special needs trust arrangements."). Some also cite to the Restatement (Second) of Contracts. See HINDERT ET AL., *supra* note 90, § 16.02[2][f] (holding that a contract can be assigned unless (a) the substitution of the right would materially change the obligor's duty, burden, risk, or materially reduce the value of his contractual right, or (b) the assignment is ineffective on statutory or public policy grounds, or (c) the assignment is legitimately prohibited by contract) (citing RESTATEMENT (SECOND) OF CONTRACTS § 317(2) (1981)).

254. HINDERT ET AL., *supra* note 90, § 16.02[2][e] ("When Article 9 was revised in 1999, a major purpose was to expand the range of financial obligations covered by Article 9, and thus eligible for assignment despite contractual anti-assignment language.")

255. U.C.C. § 9-102, Official Comment 15 (2000) ("Note that once a claim arising in tort has been settled and reduced to a contractual obligation to pay (as in, but not limited to, a structured settlement), the right to payment becomes a payment intangible and ceases to be a claim arising in tort."); *id.* at § 9-406(d)(1) (holding an agreement term between account debtors and assignors ineffective, with exceptions, to the extent that it "prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note"); see LESTI, *supra* note 253; HINDERT ET AL., *supra* note 90, § 16.02[2][e]. See generally *id.* § 9-101 (citing § 9-102 for the definition of a "Commercial tort claim").

ignore anti-assignment language in structured settlement contracts.<sup>256</sup> However, there are substantive counter-arguments to the assertion that Article 9 applies to structured settlement factoring transactions.<sup>257</sup>

## 2. Factoring Discount Rates

In allowing factoring, it is important to recognize that the cost of factoring to a structured settlement recipient may render such transactions adverse to public policy goals. Again, the purpose of the tax subsidy is to encourage plaintiffs to delay receipt of their money so as to maintain funds for their later life needs. Even if a change in circumstances places the owner of a structured settlement in a difficult financial position, selling their future stream of income at a high discount rate could reduce their award or settlement value so as to *guarantee* that their later financial needs will not be met.<sup>258</sup>

Historically, discount rates have been very high, even reaching 55%, 65%, and 75%.<sup>259</sup> This means that a structured settlement owner due future payments with a present value of \$100,000 might sell the stream of income for an immediate lump-sum of \$25,000. Authors point to plaintiffs selling their future payments in desperation as the primary cause of the factoring industry's growth.<sup>260</sup>

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256. HINDERT ET AL., *supra* note 90, § 16.02[2][e] (specifically noting § 9.318(4) of Article 9 prior to the 1999 Revision, and § 9-109(d)(8) of Article 9 of the 1999 Revision).

257. U.C.C. § 9-109(d)(8) (2000) (holding Article 9 inapplicable to “a transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable”); *see* HINDERT ET AL., *supra* note 90, § 16.02[2][e]; LESTI, *supra* note 253, § 19:11. In fact, the majority of states have specifically legislated that Article 9 is inapplicable to structured settlements. HINDERT ET AL., *supra* note 90, § 16.02[2][e].

258. Goldberg & Mauro, *supra* note 1, at 64. Of course, the high discount rate may very well result from the structured settlement recipient's lack of other options. *See* Halpern, *Protecting Plaintiffs From the Squandered Settlement*, N.C. L. WKLY., Dec. 1, 2008, at 13. Those in the factoring industry agree that claimants selling structured settlements are typically in “dire straights . . . and with no other options.” Cravenho Interview, *supra* note 187. As few as 10% of those selling their settlements are likely not in such an ominous situation. *Id.* In analyzing the 1999 proposed factoring legislation, the Joint Committee on Taxation acknowledged the argument that “deep discounting of the value of the payment stream may financially disadvantage injured persons that the [subsidy] was designed, in part, to protect.” JOINT COMM. ON TAXATION, 106th CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999).

259. Sale of Structured Settlements Received in Tort Claims: Disclosure and Court Approval Requirements: Hearing on S.B. 491 Before the S. Judicial Comm., 1999 Leg. (Cal. 1999) (statement of Sen. Johnston); Andrada, *supra* note 36, at 472 (citing Mannix, *supra* note 27, at 66; O'Connell, *supra* note 27, at A8).

260. Andrada, *supra* note 36, at 473 (describing factoring as an option of “last resort”).

Until recently, discount rates decreased substantially. Though high discount rates of 30% or more were common in the early 1990s, they dropped by half before the end of the decade,<sup>261</sup> averaging between 16% and 18%.<sup>262</sup> The decline continued until the financial crisis in 2008.<sup>263</sup> The average discount rate may have reached as low as 8% or 9%,<sup>264</sup> though some companies continued to charge rates between 15% and 20%.<sup>265</sup> However, after the 2008 financial crisis, average rates rose again to over 14% or 15% within the first few months of 2009, often approaching 20%.<sup>266</sup>

Some argue that high discount rates are a necessary evil.<sup>267</sup> Such authors have pointed to the need for factoring companies to borrow money at high rates,<sup>268</sup> increasing their total capital costs.<sup>269</sup> Clearly,

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261. Scales, *supra* note 2, at 930 (citing Interview with Earl Nesbitt, Vice President and General Counsel, Settlement Capital Co., in Halladale, Fla. (Oct. 29, 2001)). *But see* Sale of Structured Settlements Received in Tort Claims: Disclosure and Court Approval Requirements: Hearing on S.B. 491 Before the S. Judicial Comm., 1999 Leg. (Cal. 1999) (statement of Sen. Johnston) (reporting above 50% rates in 1999); 1999 Hearing, *supra* note 15, at 33 (Statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (reporting an average discount rate of 16% to 22%, but acknowledging discount rates of 30% in some circumstances).

262. 1999 Hearing, *supra* note 15, at 18 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

263. Bracy Interview, *supra* note 28.

264. *Id.* (estimating an average discount rate between 9% to 11%); Cravenho Interview, *supra* note 187 (estimating an average discount rate between 8% to 10%).

265. Cravenho Interview, *supra* note 187. Others estimate that the average discount rate in early 2008 was 13%, but climbed to 16% or higher in late 2008, primarily due to the lack of available capital. Nesbitt E-mail, June 19, 2009, *supra* note 225. Had the crisis not occurred, Nesbitt believes that the rate would have fallen to an average of 12%. *Id.*

266. Bracy Interview, *supra* note 28; *cf.* Cravenho Interview, *supra* note 187 (indicating rates of 10% to 12% at the beginning of 2009). As noted in the Part III.B., funding for factoring companies has become less available, and thus the price of borrowing such funds has increased. Bracy Interview, *supra* note 28. As a result, discount rates have increased. *Id.* Discount rates will also likely be higher for riskier annuities, such as AIG. Still, at least some factoring companies will purchase AIG annuities. *Id.* (stating that Settlement Capital Corp. will do so). There was a report in 2009, however, that discount rates were available for as low as 7.75%. John D. Darer, *If You Have to Sell, Don't Get Ripped Off! Effective Discount Rates as Low as 7.75%*, STRUCTURED SETTLEMENTS 4REAL, [http://structuredsettlements.typepad.com/structured\\_settlements\\_4r/2009/08/if-you-have-to-sell-dont-get-ripped-off-effective-discount-rates-as-low-as-775.html](http://structuredsettlements.typepad.com/structured_settlements_4r/2009/08/if-you-have-to-sell-dont-get-ripped-off-effective-discount-rates-as-low-as-775.html) (Feb. 19, 2010).

267. *See* Scales, *supra* note 2, at 930.

268. *Id.* at 931 (citing J.G. Wentworth Amended Registration Statement, at <http://www.sec.gov/archives/edgar/data/1047706/0000950115-97-001940.txt> (Dec. 11, 1997)) (citing a borrowing rate of 9%).

269. Scales, *supra* note 2, at 931 (noting capital costs of between 11% and 14%); *see also* 1999 Hearing, *supra* note 15, at 33 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding) (pointing to capital costs as high as 10%

a factoring company cannot offer discount rates below what is required for operating costs. However, although the business model may demand such high rates, its cost to structured settlement recipients could still render factoring a contravention of public policy.

Of course, factoring companies are not forcing themselves on structured settlement recipients. Former personal injury claimants voluntarily enter into such transactions. And, in fact, the factoring industry claims that 92% of claimants who sell their right to future payments are satisfied with their decision.<sup>270</sup> According to factoring industry statistics, these owners likely understand what they are losing. According to J.G. Wentworth, over 70% of surveyed structured settlement sellers received periodic payments for over ten years.<sup>271</sup> Another factoring company reported that over 85% of structured settlement sellers are gainfully employed.<sup>272</sup>

Still, many describe selling as a decision of “last resort.”<sup>273</sup> The latter description likely explains why some factoring companies are reporting increased purchasing<sup>274</sup> even as discount rates climb.

### 3. *Undermining and Promoting the Subsidy’s Purpose*

Having recounted the nature of factoring, we can consider whether allowing factoring truly undermines Congress’s purpose in creating the tax subsidy. Clearly, the ability to sell one’s structured settlement undermines the self-binding nature of the structured settlement. Equally clear, the significant losses incurred via high discount rates may increase the chances of former claimants requiring later government support, again undermining the tax subsidy’s purpose.

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as a result of “not hav[ing] access to traditional sources of capital”). Because the safety net of state guaranty associations may very well not apply to factoring companies, access to capital is more expensive. *See* Settlement Quotes, A Couple Points, Oct. 30, 2008, <http://www.structuredsettlement-quotes.com/blog/?p=171#more-171> (stating that the protections of guaranty associations do not apply to factoring companies).

270. 1999 *Hearing*, *supra* note 15, at 20 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of the National Association of Settlement Purchasers).

271. The #1 Reason, *supra* note 18.

272. 1999 *Hearing*, *supra* note 15, at 35 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the National Association of Settlement Purchasers) (representing that more than 85% of those selling are employed and without long term disability).

273. Andrada, *supra* note 36, at 473; Bracy Interview, *supra* note 28.

274. Bracy Interview, *supra* note 28 (reporting an increase in purchasing volume of 10%). As noted elsewhere, however, decreased access to funding has severely limited the amount of purchasing that some factoring companies can afford. *See supra* Part III.B.

However, in two equally significant ways, factoring allows the structured settlement tax subsidy to operate and fulfill its purpose of discouraging premature settlement dissipation.

As noted, there is a strong argument for allowing structured settlement recipients to sell their future periodic payments when they encounter unpredicted financial changes. In those situations, factoring does not violate the justification.<sup>275</sup>

Second, for all structured settlement payees, those in financial straits and those not, factoring does not reduce the incentive to structure. It is true that nearly all applications for factoring transactions are approved.<sup>276</sup> But, it is also true that many plaintiffs may utilize a structured settlement only because they learn of the ability to factor.<sup>277</sup> And, it must be remembered that the factoring company is not entitled to the same tax subsidy exclusion of periodic payments as the claimant.<sup>278</sup> As a result, the company's payment to the claimant will not incorporate the value of the tax subsidy.<sup>279</sup> Thus, in choosing to factor, the claimant must sacrifice the monetary encouragement that Congress legislated to encourage the use of structured settlements. Though factoring allows claimants to alienate the future rights that Congress hoped they would not, the tax subsidy continues to operate, discouraging them from doing so.

In fact, the ability to factor likely supports the tax subsidy's goal by encouraging the use of structured settlements. Before factoring became common, several commentators noted that the inability to alienate one's future payments was a strong disadvantage to the structured settlement.<sup>280</sup> This is no longer the case. Practitioners have noted that the increased flexibility of the modern structured settlement makes their use more likely,<sup>281</sup> though only 5% actually end up factoring.<sup>282</sup> Thus, while it is true that Congress's implicit approval of factoring,

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275. It could be argued that one's knowledge of the ability to factor in the case of financial challenge renders one more likely to end up in financial straits.

276. *See supra* note 238.

277. Meligan Interview, *supra* note 31. *But see* McCulloch E-mail, *supra* note 17 (referring to factoring "not [as] a right, but rather a right to ask").

278. E-mail from Matt Bracy, General Counsel of Settlement Capital Corp. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law, Apr. 15, 2009; *see* I.R.C. § 104(a) (2006).

279. The lost tax subsidy is reflected by the proportionately higher discount rate. While the former claimant does not pay tax on the lump-sum purchase amount received from the factoring company, it indirectly does so through the discount rate, which must reflect the income tax cost to the factoring company for receiving the future payments.

280. *E.g.*, Yandell, *supra* note 50, at 73.

281. *E.g.*, Meligan Interview, *supra* note 31.

282. Nesbitt E-mail, Sept. 11, 2009, *supra* note 183.

after court approval, substantially erodes the application of the constructive receipt doctrine to structured settlements, doing so may very well further public policy ends.<sup>283</sup>

#### F. Looking Back at Where Congress Began

Consider where the exclusions for structured settlements began. One revenue ruling allowed a structured settlement recipient to exclude the periodic payments, after noting that the recipient had no rights to the annuity itself.<sup>284</sup> A second revenue ruling allowed the exclusion of periodic payments *because* plaintiff received “neither actual nor constructive receipt, nor the economic benefit of the present value of the damages.”<sup>285</sup> Three years later, the committee reports for the Periodic Payment Settlement Tax Act of 1982 stated, “the periodic payments as personal injury damages are still excludable from income only if the recipient taxpayer *is not in constructive receipt of or does not have the current economic benefit* of the sum required to produce the periodic payments.”<sup>286</sup>

Clearly, the 1988<sup>287</sup> and 2001<sup>288</sup> enactments relaxed the application of the constructive receipt and economic benefit doctrines to structured settlements. Plaintiffs can hold greater rights to their periodic payments than general creditors,<sup>289</sup> and sell those rights for their present value upon a state court’s approval. As the constructive receipt and economic benefit doctrines relate to the claimant’s level of control over the settlement monies, it seems logical to assert that the deconstruction of the two doctrines contravenes Congress’s stated goal of preventing claimants from quickly dissipating their settlements. Simply stated, monies cannot be prematurely dissipated unless they are received, or the right to receive them in the future is alienable.

However, though a structured settlement recipient has been given greater and more flexible rights with regard to their expected future periodic payments, the strong incentive of the tax subsidy endures.

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283. It is important to remember that where court approval is a rubber-stamp, rather than the result of substantive consideration, the argument may fail to hold. *See supra* Part III.D.

284. Rev. Rul. 79-220, 1979-2 C.B. 74.

285. Rev. Rul. 79-313, 1979-2 C.B. 75.

286. H.R. REP. NO. 97-832, at 4 (1982) (emphasis added); S. REP. NO. 97-646, at 3 (1982) (emphasis added).

287. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(A)-(B), 102 Stat. 3342.

288. Victims of Terrorism Tax Relief Act of 2001, Pub. L. No. 107-134, § 5891, 115 Stat. 2436 (2002).

289. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079(b)(1)(B), 102 Stat. 3342.

Personal injury victims considering the use of a structured settlement are now encouraged by the increased security of their future payments, due to the 1988 amendment, as well as the alienability of their future payments, due to the 2001 legislation. In considering whether to sell one's payments however, the created subsidy operates to incentivize against doing so.

#### IV.

##### HELPING THE WRONG PARTY

Thus far, this Article has demonstrated the initial applicability and subsequent erosion of the constructive receipt and economic benefit doctrines as applied to structured settlements. This Part provides the context for the most recent, and quite substantial continuation of these two patterns: the use of qualified settlement funds in single-claimant cases, to be discussed in Part V. As will be shown, qualified settlement funds in single-claimant cases are sometimes used to circumvent a defendant's or liability insurer's ability to reap a substantial portion of a structured settlement's monetary benefits. This section describes the three ways that defendants and liability insurers can do so, and argues that such an ability may contravene Congress's purpose in subsidizing structured settlements.<sup>290</sup>

##### A. *Capturing the Monetary Benefits of a Structured Settlement*

Proponents of structured settlements often speak of a structured settlement's ability to benefit both sides, allowing plaintiff to receive more, while defendant pays less.<sup>291</sup> Defendants are able to capture much of the benefit resulting from the use of a structured settlement. Likely for this reason, those inside and outside the industry believe that the structured settlement was either a "defense tactic"<sup>292</sup> from the beginning,<sup>293</sup> or became one thereafter.<sup>294</sup> Often represented by their

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290. Of course, benefits accrue to defendants and liability insurers without the subsidy. However, the subsidy increases the benefits by increasing the overall number of structured settlements.

291. See, e.g., Scales, *supra* note 2, at 880–81; Goldberg & Mauro, *supra* note 1, at 39; A *Roundtable*, *supra* note 10, at 70 (comments of Roger Warin).

292. Risk, *Structured Settlements*, *supra* note 19, at 868.

293. *Id.*

294. Scales, *supra* note 2, at 897 (Scales reports being told by a major multi-line insurer when researching the structured settlement that it has been "a defense product from the beginning"). In 1999, the factoring industry argued that insurance companies use structured settlements to reduce costs. 1999 *Hearing*, *supra* note 15, at 36 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the NASP). NASP presented evidence from an insurance company's manual; "The primary objective in expanding the use of structured settlements is to maxi-

insurers during settlement negotiations,<sup>295</sup> defendants have enjoyed the advantages of experience, partly as a result of being “repeat players.”<sup>296</sup> As a consequence, some argue that “physically injured victims often are victimized a second time, unknowingly to them, when the settlement is made.”<sup>297</sup> Over the years, estimates of defense-side savings have decreased from between 50% and 75% in 1974,<sup>298</sup> to between 20% and 40% in 1978,<sup>299</sup> and recently to between 20% and 25%.<sup>300</sup> The decline is likely a result of plaintiff lawyers’ increased

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mize their value as a tool to reduce both claim loss and expense costs.” *Id.* (quoting The Travelers Structured Settlement Manual). The factoring industry also cited to a telling trial transcript. In the cited trial, counsel to State Farm argued that one of the structured settlement tax exemption’s purposes is to protect the plaintiff. *Id.* at 33 (citing Transcript of Record, Stone Street Capital v. Jackson, Civ. No. 176131). The court admonished, “No it is not. The reason for setting up these structured payments are so that the insurance companies can settle out cheaper.” *Id.* at 34. When counsel tried to respond, the court interrupted, “That is the reason. That is the reason.” *Id.* With these and other examples, the factoring industry argued that NSSTA’s antagonism for the factoring industry was based on the industry educating the public about the true value of structured settlements. *Id.* at 33 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the NASP). Similar remarks were made in contemporary articles. James D. Terlizzi, Perspective, *Understand Structured Settlement Refinancing Issues*, N.Y. L.J., Sept. 27, 1999, at L7, L15 (General Counsel and Chief Operating Officer of Peachtree Settlement Funding of Norcross, Ga., a factoring company).

295. Goldberg & Mauro, *supra* note 1, at 35–36.

296. Smith, *supra* note 56, at 1972. Commentators complain that claimants’ attorneys often allow defendants or defendants’ insurers to control the structuring of the settlement. See Risk, *Structured Settlements*, *supra* note 19, at 887. However, this problem may be diminishing, as plaintiff attorneys become increasingly assertive in the structuring of their clients settlements. See *id.* at 901. Guides to plaintiff lawyers warn readers to guard against some of defense practices discussed above. See STEPHEN J. HERMAN, *Personal Injury Settlements*, in PLAINTIFF’S PERSONAL INJURY FROM START TO FINISH 94 (2006).

297. Risk, *Structured Settlements*, *supra* note 19, at 888. Risk argues that plaintiffs are legally entitled to the tax subsidy, see *id.* at 892, and reports, “Many plaintiff attorneys who rightly were concerned over their own exposure to a legal malpractice claim by allowing the adversary to handle this transaction on behalf of their client simply had their clients take the cash.” *Id.* at 892.

298. Choulos, *supra* note 21, at 74 (citing Wallace E. Sedgwick & William C. Judge, *The Use of Annuities in Settlement of Personal Injury Cases*, 44 INS. COUN. J. 548 (1974)).

299. *Periodic Payments Prove Aid to Accident Victims*, J. COM. & COM., Mar. 20, 1978, at 8 (quoting Kenneth Wells, a consultant at Walker, Sullivan and Co. of Los Angeles).

300. Scales, *supra* note 2, at 882; see also Risk, *Structured Settlements*, *supra* note 19, at 870; JOINT COMM. ON TAXATION, 106TH CONG., TAX TREATMENT OF STRUCTURED SETTLEMENT ARRANGEMENTS (Comm. Print 1999) (“[A]nother possible outcome is that the defendant could spend somewhat less . . . and purchase an annuity as part of a structured settlement arrangement that would pay the recipient . . . [less] annually for the rest of his or her life. Under this scenario, the recipient would be indifferent as between choosing the structured settlement arrangement and receiving a

familiarity with structured settlements and the use of plaintiff-side brokers.<sup>301</sup> Of course, these estimates are just that, estimates.<sup>302</sup> The author was unable to find any empirical support.

Whether or not such savings occur frequently today, defendants and liability insurers have proven themselves *capable* of utilizing the structured settlement to minimize<sup>303</sup> their damages in three ways: (A)

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lump sum payment of [more money]. . . . However, the defendant would save [a substantial amount] in expenditures to settle the case.”).

301. HINDERT ET AL., *supra* note 90, § 1.04[4] (“During the early development of structured settlements, defendants maintained an information and resource advantage over plaintiffs, a condition that dissipated in the 1990’s.”) (citing Rudnitsky & Blyskal, *supra* note 9, at 29); NSSTA Letter, *supra* note 14, at 3 (asserting that both defendants and plaintiffs generally have brokers); Darer Interview, *supra* note 227 (noting that while some plaintiffs may agree to a structured settlement without a structured settlement expert, such cases are becoming increasingly rare, as their attorneys become educated on the increasing complexity of settlement planning issues and bring in settlement consultants as part of the team). See Bracy Interview, *supra* note 28 (stating that plaintiff attorneys and plaintiff-side brokers became more aware of structured settlements about ten years ago, and that both plaintiffs and defendants often have brokers); Ulman E-mail, Feb. 16, 2009, *supra* note 39 (noting that claimants attorneys have become more knowledgeable about structured settlements).

302. Some question whether defendants truly save money by using structured settlements at all. E-mail from Patrick J. Hindert, Managing Director, S2KM Ltd., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law. (Aug. 17, 2009, 8:33:00 EDT) (on file with author) [hereinafter Hindert E-mail, Aug. 17, 2009]. They ask two important questions. First, “Where is the independent, objective proof?” *Id.* And second, “Why would an informed plaintiff attorney ever knowingly accept a lower fee from his client for a structured settlement costing defendants less than an alternative cash settlement?” *Id.* The author could find no data to answer the first question. However, the second question can be answered. Calculating the alternative fees from a structured versus lump-sum settlement may be outside of the plaintiff attorney’s abilities. Where defendants do save money, that same commentator lists the primary reasons as “(1) misrepresentation, 2) failure to disclose; or 3) negotiation pressure.” *Id.* Thus, he recommends that plaintiff attorneys be “more aggressive in discovery to elicit information from defendants about structured settlement compensation, conflicts of interest, and company policies as well as more accurate cost and present value calculations.” *Id.* (“If you ignore profits from product sales and assume full disclosure of compensation and costs with no misrepresentations and no unauthorized practice of law (agents providing legal services to save defendants legal costs), I don’t see how defendants save money using structured settlements.”).

303. It may be more accurate to describe defendants as minimizing damages, or offsetting costs, rather than “saving” through these three strategies. Some disagree with the characterization of these practices as “savings.” E-mail from Richard B. Risk, Jr., Attorney, Risk Law Firm, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Aug. 15, 2009, 12:16:27 EST) (on file with author) [hereinafter Risk E-mail] (using language such as “bridging the gap” or “offset[ing] the cost of settling a claim”). However, the term “saving” is used here simply to mean that defendants end in a financially superior position by using a structured settlement than by using a lump-sum. This is done by either paying less, or by recouping some of their payment by profiting elsewhere.

negotiating future payments based on nominal, rather than real value, (B) profiting through the purchase of the structured settlement annuity, and (C) negotiating to benefit from the tax subsidy.<sup>304</sup> Based on the research below, the author concludes that defendants and liability insurers do minimize settlement costs through structured settlements today. Because the tax subsidy encourages structured settlements, it makes the first two cost minimization methods more available.

### 1. *Negotiating on Nominal Terms*

Due to inflation, one dollar in ten years is worth far less than one dollar today. If invested prudently, one dollar today will increase in value faster than inflation. Thus, a defendant who can promise plaintiff \$100,000 spread out in monthly payments over ten years is far better off doing so than paying plaintiff \$100,000 in cash today. As will be shown below, defendants prefer to negotiate in terms of future nominal dollars, rather than present value. Defendants have been utilizing this strategy, called a “short-changing scheme”<sup>305</sup> by a court of law, for over four decades.

Many have documented defendants and their insurers not disclosing the present value or cost of the structured settlement to plaintiff in the past.<sup>306</sup> By withholding such information, defendants deceive<sup>307</sup>

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304. The frequency of these strategies being successfully practiced today will be discussed. One settlement planner believes them to be practiced “rarely,” “frequently,” and “occasionally,” respectively. E-mail from Jack L. Meligan, Plaintiff Loyal Settlement Planner, Settlement Professionals Inc., to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Aug. 20, 2009, 3:54:43 EST) (on file with author).

305. *Macomber v. Travelers Prop. & Cas. Corp.*, 804 A.2d 180, 186 (Conn. 2002); see *Lyons v. Med. Malpractice Ins. Ass’n*, 730 N.Y.S.2d 345, 346, 286 A.D.2d 711, 712 (N.Y. App. Div. 2001) (reversed and remanded on the factual issue of insurer representation after finding privity between a plaintiff and defendant for purposes of the represented value of the structured settlement).

306. See Andrada, *supra* note 36, at 471–72; ROBERT W. WOOD, *TAXATION OF DAMAGE AWARDS AND SETTLEMENT PAYMENTS* § 7.24 (3d ed. 2005) [hereinafter WOOD, *TAXATION OF DAMAGE AWARDS*]; LESTI, *supra* note 253, § 1:2; Risk, *Structured Settlements*, *supra* note 19, at 888; Frolik, *supra* note 55, at 573–74; 1999 *Hearing*, *supra* note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of NASP); *id.* at 34 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding); *A Roundtable*, *supra* note 10, at 76 (comments of Herb Cumming). *But see* NSSTA Letter, *supra* note 14, at 3 (“Industry practice is to provide the claimant and counsel with a detailed factual presentation regarding the cost of various components of the settlement, including the annuity cost and total future payout for the structured payments. Industry practice is to spell out the annuity cost as part of the settlement offer. Plaintiff’s counsel has to know the cost of the structured settlement annuity in order to calculate the attorney’s fee, which must be determined on the basis of the present value of the settlement.”). Some in the insurance industry argue that it is not difficult for a plaintiff attorney to learn the

plaintiffs into believing that the settlement is worth more than its true value.<sup>308</sup> For example, one case regarded the representation by the Medical Malpractice Insurance Association to plaintiffs that a structured settlement package, including an annuity providing for payments of \$3,000 per month for life to an infant, carried a present value of \$940,180.<sup>309</sup> In fact, the package's true present value was \$410,000.<sup>310</sup>

In the past, the insurance industry has taken steps to maintain plaintiffs' lack of present value information. It has done so both through misinformation and political action. For years, defendants and insurers maintained that plaintiffs and their attorneys could not know the present value or cost of a structured settlement without breaching constructive receipt.<sup>311</sup> Such receipt would prevent plaintiff from utilizing the tax benefit of section 104(a)(2). This has been held untrue.<sup>312</sup> Later, defendants and insurers also asserted that involve-

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present value of an offered structured settlement. See Dyer Interview, *supra* note 53. Though a broker providing such information may not earn a commission by advising in that transaction, he or she will often advise anyway, hoping to make commissions on the requesting attorneys' subsequent settlements. See *id.*

307. Some commentators find defendants' representation of structured settlements' values to constitute fraud. Risk, *Structured Settlements*, *supra* note 19, at 889. Others simply argue that a claimant's attorney should always know the cost to defendant. See *A Roundtable*, *supra* note 10, at 76 (comments of Lawrence Charfoos); *id.* at 76 (comments of Herb Cumming).

308. See Andrada, *supra* note 36, at 471-72; WOOD, TAXATION OF DAMAGE AWARDS, *supra* note 306, § 7.24; LESTI, *supra* note 253, § 1:2; Goldberg & Mauro, *supra* note 1, at 44; Frolik, *supra* note 55, at 573-74; 1999 Hearing, *supra* note 15, at 19 (written statement of John E. Chapoton, Partner, Vinson & Elkins, L.L.P., on behalf of NASP); *id.* at 34 (written statement of Timothy J. Trankina, CEO of Peachtree Settlement Funding, on behalf of the National Association of Settlement Purchasers); Terlizzi, *supra* note 294, at L7 (General Counsel and Chief Operating Officer of Peachtree Settlement Funding of Norcross, Ga., a factoring company); *A Roundtable*, *supra* note 10, at 76 (comments of Herb Cumming). However, Cumming noted that plaintiff attorneys had a relatively new tool available, Merrill Lynch's Total Agreement program, which enables a plaintiff attorney to "determine the value of a case and then to consider what income stream that money could provide to best meet the needs of the client, given his or her age, family situation, and so forth. . . . The present day value or cost of a settlement need not be a secret anymore." *Id.*; see also *id.* at 80 (comments of Charles Krause).

309. *Lyons v. Med. Malpractice Ins. Ass'n*, 730 N.Y.S.2d 345, 346 (N.Y. App. Div. 2001).

310. *Id.*

311. *E.g.*, Joseph E. Murphy, *Structured Settlements*, THE VERDICT, Oct. 1986, at 11 ("It is of the utmost importance that in describing such an annuity, the purchase price of the annuity not be mentioned but simply the schedule of payments."); *cf.* Gregware Interview, *supra* note 17 (stating that over fifteen years ago, it was widely believed that claimant knowledge of present value would constitute constructive receipt).

312. See I.R.S. Priv. Ltr. Rul. 90-17-011 (Jan. 24, 1990) ("[T]he exclusion from gross income does not apply to punitive damages in connection with a case not result-

ment of a plaintiff broker in structured settlement negotiations constitutes constructive receipt.<sup>313</sup> Commentators have argued that this is false as well.<sup>314</sup>

The insurance industry has also worked to prevent plaintiff-side support for structured settlement negotiations from growing. One commentator argues, “Although [NSSTA’s] mission statement does not overtly exclude plaintiff advocates, NSSTA was organized by those who wanted to preserve the structured settlement concept as a defense tool.”<sup>315</sup> For example, in 1999, NSSTA worked to defeat proposed legislation in both Florida and New Hampshire that would have allowed structured settlement plaintiffs to select their broker and funding structure.<sup>316</sup> Members of NSSTA have acted similarly. From early on, commentators report, “annuity issuing life insurance companies . . . restricted their appointments to those brokerages (general agencies) that would prohibit their individual agents from working on behalf of injury victims and their attorneys.”<sup>317</sup> While many of these tactics are no longer employed, others allegedly continue.

Currently, there is a class action against Hartford Financial Services Group alleging that Hartford’s liability insurer subsidiaries “operate in tandem [with inside and outside brokers] to deliberately erect an information barrier to protect defense interests.”<sup>318</sup> Plaintiffs also allege that Hartford and its in-house brokers “colluded to submit falsely inflated cost information to unwitting injury claimants (and their attorneys when retained) about the true amount of money which Hartford invests to purchase the funding annuity.”<sup>319</sup>

There is some question as to the frequency of this practice occurring today. As one attorney puts it, “Today, only a very naïve attorney would not insist on knowing the cost of the proposed settlement on behalf of a client. Unrepresented claimants, however, might still be

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ing in physical injury or physical sickness.”); *see also* I.R.S. Priv. Ltr. Rul. 83-33-035 (May 16, 1983) (“[Y]ou will have neither actual nor constructive receipt, nor the economic benefit of the present value of the amount invested in the annuity, and the periodic payments will be excludable from your gross income under section 104(a)(2) of the Internal Revenue Code.”).

313. Risk, *Structured Settlements*, *supra* note 19, at 894.

314. *Id.* at 895.

315. *Id.* at 881.

316. *Id.*

317. *Id.* at 882.

318. Plaintiff’s Class Complaint at ¶ 41, Doc. 1, *Spencer v. Hartford Fin. Serv. Group*, (No. 3:05-cv-01681-JCH) (D. Conn. Oct. 31, 2005). The complaint alleges that Hartford’s liability carriers “typically do not reveal to injury claimants (or their attorneys) any information about the commission agreements they have with their appointed brokers.” *Id.*

319. *Id.* at ¶ 43.

misled and taken advantage of by this tactic.”<sup>320</sup> Thus, the occurrence of this strategy, as opposed to the subsequent two, may be rare.<sup>321</sup>

## 2. *Defendants’ Insurers Can Profit from Structured Settlements*

Where the casualty insurer is part of a larger insurance company, which also holds a life insurance company, the insurer can profit by purchasing an annuity from its affiliate. Plaintiff representatives report cases of defendants’ insurers refusing to structure a settlement unless the annuity was purchased from the company’s approved list of life insurance companies.<sup>322</sup> Unfortunately, that list might exclusively consist of affiliate companies, and non-affiliated companies with sub-standard annuities.<sup>323</sup>

Internal insurer memos published show that some insurers have done their best to purchase from affiliates in the past.<sup>324</sup> Where the

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320. Risk E-mail, *supra* note 303.

321. See Meligan E-mail, *supra* note 304 (suggesting that it is “rare”).

322. E-mail from Lawrence Grassini, Partner, Grassini & Winkle, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 20, 2009, 15:07:38 EST) (on file with author) [hereinafter Grassini E-mail] (noting a case within the last few years); E-mail from Ritch McBride, President, Plaintiff-Quote.Com, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 23, 2009, 14:46:22 EST) (on file with author) [hereinafter McBride E-mail].

323. Grassini E-mail, *supra* note 322 (discussing such a case); McBride E-mail, *supra* note 322. One might respond that liability insurers would always wish to find the best priced annuity so as to limit costs. However, some argue that the benefit of directing business to an affiliate or friendly life insurance company is sometimes greater. *Id.* Life insurance companies’ approved lists are sometimes available. For example, AIG’s 2007 list of approved life insurance companies included its two affiliates, American General Life Insurance Co., American International Life Assurance Co. of NY, and four other life insurance companies: Allstate Life Insurance Co., Hartford Life Insurance Co., New York Life Insurance Company, and Pacific Life and Annuity Co. Robert Peahl & Michael Miller, Webcast Seminar, Single-Claimant 468(B) Trusts, [http://web.aig.com/2007/lit6458/lit6458\\_AIG468\(B\)%20Presentation\\_v2.PPT](http://web.aig.com/2007/lit6458/lit6458_AIG468(B)%20Presentation_v2.PPT) (last visited Feb. 19, 2010).

324. E-mail from Nacado King to Alfred W. Bodi et al., cc to Kharyne Neptune, Contemporary National Director of Structured Settlements, AIG (Mar. 5, 2005, 09:44 AM), available at <http://www.settlepro.com/data/AIGSSPolicyMemo.pdf> (emphasis added) (“Our recommended quoting practice is as follows: Our preferred method of negotiating a case is to make all offers in the form of a structured settlement. . . . When the case settles for an agreed upon dollar value with the understanding that a portion of the settlement will be placed in a structure, then the broker should place the premium with AG or AI Life. *Unless compelled by the plaintiff or the plaintiff’s broker to illustrate competitiveness, the broker need not canvass [sic] the Approved Life list for the best quote.* If compelled, the broker must canvass the Approved List for the best available rates. The broker, however, must give AG or AI Life the last right of refusal.”). It is unclear if the policy is still in effect. The author has spoken to some in the industry who believe the policy to remain unchanged. Others say that while there may have been historical significance to the memo at one time, there have

market is not fully searched, the claimant can end up with an inferiorly rated annuity.<sup>325</sup>

Even if the casualty insurer is not part of a larger insurance company, it can profit by structuring a settlement through the chosen broker. Since 1979, liability insurers have developed relationships with structured settlement brokers and brokerage companies.<sup>326</sup> A liability insurer might almost exclusively hire those particular brokers,<sup>327</sup> refusing to structure a settlement unless their broker is used.<sup>328</sup> In exchange for this business, it has been reported that brokers will often share their commission on annuity purchases for structured settlements with the liability insurer.<sup>329</sup>

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been substantial changes at AIG since. Darer Interview, *supra* note 227. Therefore, Darer asserts, those utilizing and relying on the memo are “doing their readers a great disservice by implying that the same exists today.” *Id.* Still, there are casualty insurance companies today who strongly push to use affiliate life insurance annuities. *Id.* But see Ulman E-mail, Feb. 16, 2009, *supra* note 39 (stating that liability insurers are “often indifferent” to the identity of the life insurer whose annuity contract funds the settlement, assuming that the insurer has strong ratings). However, some argue that this may not be a problem provided that the affiliated company offers a structured annuity with a competitive rate-of-return, has a good balance sheet, and can meet plaintiff’s diversification objectives. Darer Interview, *supra* note 227. Unfortunately, casualty companies sometimes push for the use of an affiliate that does not meet such needs. *Id.*

325. McBride E-mail, *supra* note 322 (saying that a lesser quality annuity will “often” be the result); Darer Interview, *supra* note 227 (stating that the use of an approved list will “sometimes” be problematic).

326. Risk, *Structured Settlements*, *supra* note 19, at 879.

327. *Id.* A class action against Hartford Financial Services Group alleges that Hartford and its approved brokers failed to disclose to claimants that Hartford recaptures brokerage fees by “secretly bundling the broker’s four percent (4%) commission into the represented annuity cost. Nor does Hartford reveal that even if a portion of this four percent (4%) ‘built-in commission’ is not paid to the Approved Broker or In-House Broker, for whatever reason, it is still kept by Hartford for itself.” Plaintiff’s Class Complaint, *supra* note 318, at ¶ 44, Doc. 1. Of course, as Hartford argues in its motion to dismiss, plaintiffs do not allege that they received less compensation than promised. Defendant’s Motion to Dismiss, 2–3, Doc. 28-3, *Spencer*, No. 3:05-cv-01681-JCH (Feb. 1, 2006). Their claim, rather, is that Hartford misrepresented the cost of making the promised compensation possible. See *id.* It has also been reported that claimants are sometimes sent a copy of checks made out to life insurance companies, though a portion of those checks will be refunded. Risk, *Structured Settlements*, *supra* note 19, at 888. In addition, the factoring industry has alleged that “illegal kickbacks and rebates [were given by] structured settlement brokers in exchange for directing business to said brokers.” 1999 Hearing, *supra* note 15, at 29 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

328. Grassini E-mail, *supra* note 322; McBride E-mail, *supra* note 322.

329. 1999 Hearing, *supra* note 15, at 29 (statement of Timothy J. Trankina, Founder and CEO of Peachtree Settlement Funding).

### 3. *Defendants Can Capture Some of the Tax Subsidy*

As noted, the greatest advantage of structured settlements for defendants is the ability to pay less.<sup>330</sup> The tax subsidy renders structured settlements more valuable to plaintiffs, perhaps by 20% or more, than their cost to defendants.<sup>331</sup> However, while it is claimant who will directly benefit from their increased value, defendant can indirectly benefit by demanding a decreased settlement payment.<sup>332</sup> Depending on the size of the reduction in defendant's cost, the claimant may reap all, or none, of the tax benefit. While plaintiffs benefit from the exclusion,<sup>333</sup> defendants do as well.<sup>334</sup> Moreover, some observe that defendants leverage their negotiating power, threatening to withdraw the option of a structured settlement in order to benefit from controlling the selection of the structured settlement annuity provider and broker.<sup>335</sup> Thus, the subsidy increases the chance of profiting through the purchase of the annuity, as described in Part IV.A.2.

#### *B. Defendants' and Liability Insurers' Capture May Detract from the Subsidy's Goal*

While encouraging the defense to make larger and periodic payments to plaintiffs is consistent with the tax subsidy's purpose, as doing so decreases the likelihood of plaintiffs' later dependence on the government, reducing defendants' damages is likely not consistent.<sup>336</sup>

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330. Andrada, *supra* note 36, at 471–72.

331. E-mail from William L. Neff, Partner, Hogan & Hartson LLP to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 6, 2009, 11:48:12 EST) (on file with author) [hereinafter Neff E-mail, Feb. 6, 2009] (offering a generally used estimate of savings, stating that “the present value of the stream of tax free earnings is approximately 20% higher . . . than developing the same stream of payments if the earnings were taxable”).

332. Some refer to this strategy as the “Section 130 veto.” Risk E-mail, *supra* note 303 (noting that he coined the term “to describe the leverage defendants and their liability insurers traditionally use to coerce claimants into submitting to structured settlements controlled by the tortfeasors or their liability insurers, through intimidation by threatening loss of benefit. If the claimant refuses a structured settlement offer by a defendant or its insurer, seeking to have the claimant's own chosen structured settlement producer handle the transaction, the defendant or its insurer often will then tell the claimant that the entire settlement will be paid as a cash lump sum.”).

333. See WOOD, TAXATION OF DAMAGE AWARDS, *supra* note 306, § 7.24.

334. Risk, *Structured Settlements*, *supra* note 19, at 872.

335. Risk, *A Case*, *supra* note 7, at 673; see Meligan Interview, *supra* note 31 (describing how defendants or their casualty insurers will sometimes make one structured settlement offer if plaintiff will agree to using the casualty insurer's life insurance affiliate, and a lower value offer if plaintiff refuses).

336. This is not to suggest that it is in the interest of public policy to increase defendants' payments, merely that decreasing defendants' payments below the value of the harm caused is not, in and of itself, in the interest of public policy.

While this is elaborated upon below, it should also be remembered that any augmentation of plaintiffs' financial ability to cover future needs likely furthers the subsidy's goal.

When considering whether to act in a given way, a logical person will weigh possible advantages and disadvantages. A tortfeasor employer, for example, considering whether to implement costly safety measures, considers the savings and potential damages of that decision. Where the potential damages are slight, such an employer will more readily disregard safety measures.<sup>337</sup> Simply put, "the incentive to take care will be reduced."<sup>338</sup> For this reason, some argue, "Making the defendant pay for the full harm is required [to fully achieve] deterrence."<sup>339</sup> The structured settlement tax subsidy, as shown above, reduces potential damages of tortious actions. One commentator suggests that the structured settlement tax subsidy carries the same effect as "a 'tort reform' measure that simply provide[s] that the federal government would reimburse tort defendants for 20% of their costs . . . structures are not actually used to provide plaintiffs with greater recovery, but to diminish the liability of their injurers."<sup>340</sup> Of course, the reduction in deterrence will impact risk-takers' actions at the margins, and it is impossible to know how much. However, in creating or maintaining a tax subsidy with the effect of reducing deterrence, Congress must be sure that the advantages for public policy outweigh the detriment of reduced deterrence.

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337. See generally Gary T. Schwartz, *W. Page Keeton Symposium on Tort Law: Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice*, 75 TEX. L. REV. 1801, 1803 (1997) (noting an "explosion of scholarship analyzing tort law in economic terms and emphasizing deterrence as a primary tort objective") (citing FOUNDATIONS OF TORT LAW (Saul Levmore ed., 1994)).

338. Smith, *supra* note 56, at 1973.

339. *Id.* at 1973, n.59 (2002) (citing David D. Haddock et al., *An Ordinary Economic Rationale for Extraordinary Legal Sanctions*, 78 CAL. L. REV. 1, 44-45 (1990)).

340. Scales, *supra* note 2, at 887. One could also analogize to defendants' ability to obtain the general deduction available for damages paid to plaintiffs. See Blackburn, *supra* note 61, at 687 ("If a payor is allowed to deduct damages paid, including costs of litigation, then the payor is allowed to spread such costs to the federal government and taxpayers. Furthermore, wrongdoers, just as other taxpayers, factor in the after-tax cost of their actions in shaping their behavior. Allowance of deductions for damage payments in many instances clearly frustrates public policy."). Revenue rulings go even further, allowing the deduction of punitive damages resulting from the ordinary conduct of business. Rev. Rul. 80-211, 1980-2 C.B. 57. Of course, there are exceptions and limitations. See I.R.C. § 162(f) (2006 & Supp. II 2008) (disallowing deductions for fines and government penalties for violating the law); I.R.C. § 162(g) (2006 & Supp. II 2008) (limiting deductibility of certain antitrust judgments and settlements).

Two arguments are made positing that defendants' paying less is not problematic, or at least not overly so. Some argue that it is "logically unnecessary"<sup>341</sup> for defendants to pay exactly what plaintiffs receive because defendants' costs are irrelevant to a compensated plaintiff.<sup>342</sup> However, the argument incorrectly assumes that plaintiffs' monetary compensation is the single driver of personal injury lawsuits.<sup>343</sup> In fact, multiple surveys have found that personal injury claimants are often pursuing non-monetary goals.<sup>344</sup> These include the seeking of an explanation, an apology, public vindication, or the chance to have one's side heard and respected.<sup>345</sup> Anecdotal evidence among personal injury trial attorneys affirms the observation that money is not often claimants' sole objective.<sup>346</sup> The knowledge that a defendant paid for the damage caused may be an end in itself for a plaintiff.

Some commentators also argue that the reduction in defendants' costs can benefit the public at large through reduced insurance premiums. Because liability and casualty insurers pay less, they can charge their clients less.<sup>347</sup> However, this argument ignores the negative impact on deterrence discussed in this section. While lower insurance costs would benefit those paying insurance, it would reduce the disincentive to take risks. The price of insurance is based on the risk of causing harm. Where the tax subsidy decreases the price per unit of risk, some individuals will take on risk that profits them less than it costs society.

Thus, public policy dictates that where possible, and where doing so does not decrease the use of structured settlements, the monetary

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341. Joseph M. Dodge, *Taxes and Torts*, 77 CORNELL L. REV. 143, 172 (1992) (noting that a personal injury represents the loss of human capital by plaintiff, without a proportionate gain by defendant, such as in a rescission or unjust enrichment case).

342. Derek A. Cave, *Structured Settlements: An Alternate Resolution of Claims Involving Death or Substantial Personal Injury*, THE ADVOC. 331, 332 (June–July 1979); see Scales, *supra* note 2, at 888.

343. Scales, *supra* note 2, at 892.

344. Scales cites multiple sources for this proposition. *Id.* at 892–93, 893 n.104.

345. *Id.* at 892–93.

346. *E.g.*, E-mail from Gail K. Johnson, Senior Trial Counsel, Federal Tort Claims Act Section, Department of Justice to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Feb. 20, 2009, 13:06:41 EST) (on file with author) (noting that while money "is always in the mix and therefore a motivator . . . [and] remains the typical form of 'apology' and even punishment . . . the importance of it varies").

347. Choulos, *supra* note 21, at 74; see *A Roundtable*, *supra* note 10, at 72 (comments of Herb Cumming); BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS, 1997 WL 439544, pt. 2, ¶ 13.1, at \*5 (2008).

benefits of structured settlements should be directed to claimants, rather than defendants and their liability insurers.

## V.

### THE NEXT STEP AWAY FROM THE TWO TAX DOCTRINES: QSFs

In response to the defendant and liability insurer tactics described above, some plaintiffs make use of a tax entity created by Congress in the mid-1980s to facilitate mass tort settlements. Consistent with the public policy perspective discussed in the previous section, the entity, a “qualified settlement fund,” or QSF, enables a claimant to capture a greater portion of a structured settlement’s benefit, while not discouraging the use of structured settlements.

By utilizing a QSF, a claimant can control the purchase of the annuity for their structured settlement, capturing some or all of the benefits of structuring. Claimants can ask a defendant<sup>348</sup> to pay a lump-sum settlement into the QSF, which acts as a “tax-free way station,”<sup>349</sup> assuming the defendant’s liability through novation. The claimant then “negotiates” with a friendly court-appointed QSF administrator to permanently settle his or her claim through a qualified assignment, thereby satisfying the requirements of structured settlement tax subsidy eligibility.

However, where there is only one claimant, that claimant arguably obtains constructive receipt or economic benefit of the settlement monies, under a traditional understanding of the two doctrines.<sup>350</sup> The IRS may soon decide whether the control claimants gain through the use of a single-claimant QSF disqualifies them from eligibility for the structured settlement tax subsidy.<sup>351</sup> The answer is the subject of “a raging debate in the tax world.”<sup>352</sup>

This Article argues that the IRS should apply the constructive receipt and economic benefit doctrines as it and Congress have applied the two doctrines before in the context of structured settlements: narrowly or not at all. As we will see, the tax subsidy’s purpose remains effective, even in the face of such constructive receipt, and is, in fact, bolstered.

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348. As we will see, claimants can also force defendants to pay an agreed lump-sum into a QSF.

349. Robert W. Wood, *Qualified Settlement Funds: A Mechanism Whose Time Has Come*, L.A. DAILY J., July 12, 2009, at 6 [hereinafter Wood, *A Mechanism*].

350. See Part V.B.

351. *Infra* notes 401–403 and accompanying text.

352. Wood, *A Mechanism*, *supra* note 349.

### A. QSFs: More Erosion of Tax Doctrine

Section 468B of the Tax Code<sup>353</sup> creates a tax entity called a “designated settlement fund,”<sup>354</sup> sometimes referred to as a “qualified settlement fund”<sup>355</sup> or “QSF.”<sup>356</sup> Defendants can make an immediately deductible payment into a QSF, which will eventually be paid out to plaintiffs.<sup>357</sup> Thereafter, the fund assumes defendants’ liability, replacing a defendant as the party to the suit or agreement for purposes of section 130.<sup>358</sup> Thus, the QSF will be able to structure settlements with the claimant that will be eligible for the ordinary tax subsidy.

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353. I.R.C. § 468B (2006).

354. I.R.C. § 468B(d)(2) (2006).

355. While Congress used “designated settlement fund,” I.R.C. § 468B(d)(2) (2006), Treasury used “qualified settlement fund.” Treas. Reg. § 1.468B (1992). Likewise, the IRS has called trusts established pursuant to § 468B “QSFs.” I.R.S. Priv. Ltr. Rul. 2001-38-006 (May 7, 2001).

356. This Article uses the language of “QSF.” However, it notes some of the differences here. The Tax Code provides that a section 468B fund is “any fund . . . (A) which is established pursuant to a court order and which extinguishes completely the taxpayer’s tort liability with respect to claims . . . (D) established for the principal purpose of resolving and satisfying present and future claims against the taxpayer (or any related person or formerly related person) arising out of personal injury, death, or property damage.” I.R.C. § 468B(d)(2)(A), (D) (2006) (including other requirements). QSFs have less restrictions, and thus more flexibility than DSFs. ROBERT W. WOOD, QUALIFIED SETTLEMENT FUNDS AND SECTION 468B, 1-7, (2009) [hereinafter WOOD, QUALIFIED SETTLEMENT FUNDS]; *see id.* at 13-13. DSFs, for example, only operate for claims of personal injury, death, or property damage. I.R.C. § 468B(d)(2)(D) (2006). Thus, QSFs are used more frequently than DSFs. WOOD, QUALIFIED SETTLEMENT FUNDS, *supra*, at 1-8; *see id.* at 13-3 (“In practice, the QSF has eclipsed the DSF, making it largely irrelevant.”); Robert W. Wood, Tax Management Portfolios: Tax Aspects of Settlements and Judgments, 552-3rd, A-75 (BNA) (Oct. 1, 2007) (articulating other differences, which are not necessary to delineate for purposes of this Article).

357. I.R.C. § 468B(a) (2006) (“For purposes of section 461(h), economic performance shall be deemed to occur as qualified payments are made by the taxpayer to a designated settlement fund.”). Without this language, deductions could only be made as moneys are received by claimant. I.R.C. § 461(h)(2)(c) (2006 & Supp. II 2008).

358. Rev. Proc. 93-34, 1993-2 C.B. 470; I.R.C. § 130(c)(1) (2006). QSFs cannot be created for worker compensation claims. Treas. Reg. § 1.468B-1(g)(1) (as amended in 2006). The typical sequence of events to use a QSF involves: (1) either side can initiate the use of a QSF by hiring an attorney to prepare the documentation, and an administrator, often the same attorney, (2) that party petitions or moves a trial court, probate court, or government entity to establish a QSF, (3) an order establishing the QSF is entered according to Treas. Reg. § 1.468B-1, (4) a court may be required to approve the settlement, (5) the administrator creates a bank account subject to the court order establishing the QSF and the continuing jurisdiction of that court, (6) the settlement agreement is signed and the money is transferred, (7) defendants are dismissed with prejudice, and finally (8) the QSF and plaintiff establish a settlement with court approval. *Qualified Settlement Fund Sequence*, <http://www.risklawfirm.com/files/QSFSequence10-12-04.pdf> (2004).

Enacted in 1986,<sup>359</sup> the QSF grew out of mass tort settlements,<sup>360</sup> and has been used for that purpose.<sup>361</sup> Section 468B was legislated to make settlement payments to a personal injury class immediately deductible for defendants.<sup>362</sup> Though the amount defendant will eventually pay to a plaintiff class may be known, plaintiffs within the class may not yet have allocated the money amongst themselves. Section 468B allows a defendant to make an immediately deductible settlement into a QSF,<sup>363</sup> and extricate itself from the lawsuit via a dismissal with prejudice.<sup>364</sup> Thereafter, the QSF is taxed as a person,<sup>365</sup> and the appointed QSF administrator is in control of distributing the QSF monies.<sup>366</sup> Because a QSF allows the transfer of monies into a fund without the beneficiaries of that fund receiving the income for tax purposes, the authoritative treatise on QSFs describes them as “a simple trust that essentially abrogates the fundamental tax concepts of constructive receipt and economic benefit that go to the root of our federal income tax system.”<sup>367</sup>

Under Treasury regulations issued in 1993, a QSF is established pursuant to an order by a court or government entity to satisfy tortious claims,<sup>368</sup> and is subject to that entity’s continuing jurisdiction.<sup>369</sup>

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359. Tax Reform Act of 1986, Pub. L. No. 99-514, § 1807(a)(7)(A), 100 Stat. 2085 (1986).

360. Letter from Dewey Ballentine LLP to Gregory F. Jenner, Deputy Assistant Secretary for Tax Policy, Department of Treasury, et al. 1 (Oct. 8, 2003), *available at* <http://www.risklawfirm.com/files/DeweyBallentineLtrtoSenBaucus06-29-04.pdf> (authored by Stuart Odell, and Joseph K. Dowley, Former Chief Counsel of the U.S. House Committee on Ways & Means (1985–1987), representing The Pension Company) [hereinafter Dewey Ballentine Letter]; *see* William L. Winslow, *Resolving Mass Torts with Designated Settlement Funds*, 30 TRIAL 82, 82 (1994) (“special purpose funds primarily grew out of asbestos cases and other toxic tort litigation”).

361. Winslow, *supra* note 360, at 82. In the early 1990s, QSFs were used almost exclusively for large class actions. WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 1-4.

362. *See* Winslow, *supra* note 360, at 84.

363. I.R.C. § 468B(a) (2006). The earlier a deduction can be made, the more valuable it is to the taxpayer.

364. WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 1-21. The QSF assumes the defendant’s liability through novation. *E.g.*, Order Establishing the Enriquez Settlement Trust and Appointing Administrator, No. 06-CA-242-11-L, i (Fla. Cir. Ct. Seminole Cty. 2008).

365. Treas. Reg. § 1.468B-2(b)(1) (as amended in 1993); WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 1-6.

366. Though the court has continuing jurisdiction, in most cases, judges rubber-stamp distributions. *See* WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at viii, 2-6.

367. *Id.* at vii. Where there are many parties arguing over the monies in a QSF, the two doctrines may not be triggered.

368. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006). Other types of claims, such as breach of contract, are also acceptable.

Pursuant to 1993 Treasury procedure, section 130 qualified assignments can be made by QSFs for purposes of structured settlement tax subsidy eligibility because they replace the original defendant as the party to the suit or agreement for purposes of section 130.<sup>370</sup>

*B. Capturing More Benefits Through a Single-Claimant<sup>371</sup> QSF*

Soon after the Treasury issued the procedure allowing QSFs to produce subsidy-qualifying structured settlements, the most common QSF question became, “How many plaintiffs must participate in the compromise in order to use a designated settlement fund?”<sup>372</sup> Though the defense industry lobbied for section 468B’s regulatory framework in the context of mass torts,<sup>373</sup> some plaintiff lawyers and brokers have used the entity for entirely different purposes, sometimes as a “weapon.”<sup>374</sup> In order to prevent defendants and their insurers from monopolizing structured settlement negotiations and structured settlement benefits,<sup>375</sup> plaintiff attorneys argue, plaintiffs in single-plaintiff

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369. *Id.*

370. Rev. Proc. 93-34, 1993-2 C.B. 470. *See generally* I.R.C. § 130(c)(1) (2006). Before 1993, it was believed that QSFs could not use section 130 qualified assignments. Dewey Ballentine Letter, *supra* note 360, attached memo at 2.

371. Many do not distinguish between single-claimant QSFs and those with several related claimants. Wood, TAX NOTES, *supra* note 45, at 74; Dewey Ballentine Letter, *supra* note 360, at 2 n.1 (“For the purposes of this discussion, multiple-claimant situations where settlement amounts between the defendant and each claimant have been determined prior to any payment by the defendant should be considered equivalent to single-claimant situations.”); Dewey Ballentine Letter, *supra* note 360, attached memo at 3 n.7. In truth, it is not clear what constitutes a single-claimant controversy. WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 2-40. Thus, plaintiff attorneys are advised to draft complaints with alternative claims, adding other parties when possible. *Id.*; HINDERT ET AL., *supra* note 90, § 3.08B[7] (stating that some argue that Medicare and Medicaid liens “constitute separate and additional claims for purposes of 468B funds”). QSFs established with a single injured party and multiple liens or claims are sometimes called “single party” QSFs.

372. Winslow, *supra* note 360, at 83.

373. NSSTA was the “principal proponent of the issuance of Rev. Proc. 93-34.” NSSTA Letter, *supra* note 14, at 8.

374. E-mail from Michael Russell, Attorney, Garretson Firm Resolution Group, Inc. to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Apr. 20, 2009, 12:18:52 EST) (on file with author), [hereinafter Russell E-mail] (noting that QSFs are also frequently used as a “weapon” to get a defendant out of the structured settlement process); Darer Interview, *supra* note 227 (noting that some use QSFs as a “threat during negotiations”). Some plaintiff attorneys will only use the QSF if forced to. Grassini E-mail, *supra* note 322 (noting the appropriateness of using a QSF where the liability insurer refuses to structure a settlement without using its inadequate list of insurance companies or chosen broker).

375. *See* Continental Casualty v. United States, No. C 02-4891 VRW, C 02-5292 VRW, slip op., 2006 WL 3455055, at \*1 (N.D. Cal. Nov. 29, 2006) (amended order) (“Plaintiffs also seek a court order establishing a qualified settlement trust . . . presum-

settlements can direct the defendants or their liability insurers to pay a lump-sum into a QSF.<sup>376</sup> Thereafter, plaintiffs can discuss how to settle the claim with the QSF administrator in a non-adversarial context,<sup>377</sup> arranging for the purchase of an annuity through their own chosen representatives. Some estimate that between 30% to 40% of structured settlement brokers, or 5% of the industry, use single-claimant QSFs.<sup>378</sup>

While a QSF transfers control over the structuring of a settlement to a plaintiff, a defendant might demand to pay a lower lump-sum, predicting that a plaintiff will benefit from structuring soon after. If

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ably to bypass the DOJ requirements and privately create a structured payment plan.”); Meligan Interview, *supra* note 31 (noting that he may use a QSF to prevent defendant from profiting from the structured settlement, or being involved in planning plaintiff’s future). Of course, the use of a QSF must be balanced with its costs. The creation of a QSF is more complicated than a simple structured settlement. Also, their creation will typically cost between \$3,000 and \$5,000. Darer Interview, *supra* note 227.

376. Risk, *Structured Settlements*, *supra* note 19, at 892 (“plaintiffs can take control of the structured settlement process through a QSF and leave the defense out of the picture once the money has been paid into the fund”).

377. *Id.* at 893; Risk, *A Case*, *supra* note 7, at 657 (noting that selection of the QSF administrator is normally subject to claimant approval).

378. Darer Interview, *supra* note 227. Most life insurance companies will sell annuities to single party QSFs on a case-by-case basis. McBride E-mail, *supra* note 322; e.g., E-mail from Toni Griffin, Director of Public Relations, MetLife, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law (Mar. 8, 2009, 10:36:02 EST) (on file with author) (discussing MetLife’s policy). *But see* Risk, *Structured Settlements*, *supra* note 19, at 895 (noting that very few life insurance companies will sell to single-claimant QSFs). Portions of a 2001 internal memo by John Hancock tax attorneys were published in a 2001 law article, delivering the opinion that the use of a QSF does not constitute constructive receipt “merely because [the claimant] is the *single* claimant.” Risk, *Structured Settlements*, *supra* note 19, 896 n.160 (quoting Memorandum from Otto J. Preikszas, Jr. Counsel, John Hancock, to Christi Fried, Director of Structured Settlement (Feb. 24, 2000) (on file with author)). Those companies that do accept single-claimant QSFs on a case-by-case basis typically require a showing of more than one claim. McBride E-mail, *supra* note 322. However, the true single-claimant case is rare, or even nonexistent. E-mail from John Staunton, Elder Law Attorney and QSF Administrator, to Jeremy Babener, J.D. Candidate, Class of 2010, New York University School of Law. (Apr. 20, 2009, 17:25:22 EST) (on file with author) [hereinafter Staunton E-mail]; McBride E-mail, *supra* note 322. Practitioners observe that there is always some issue that can be “fairly characterized” as an additional claim. Staunton E-mail, *supra*; *see also* McBride E-mail, *supra* note 322 (noting that any case can be characterized as a multiple-claimant case as a result of possible Medicare future interests). These are often Medicaid or Medicare liens, sometimes being “potential claim[s].” Staunton E-mail, *supra*; *see also* McBride E-mail, *supra* note 322; Russell E-mail, *supra* note 374 (observing that some attorneys use potential claims to constitute multiple claims). Some firms that act as QSF administrators will not accept QSF single party cases unless obligations that could constitute other claimants exist. *Id.* (noting that his firm will work hard to establish that multiple-claimants exist).

done, plaintiff would be less capable of capturing the benefits of a structured settlement. Once defendants have agreed to a lump-sum settlement payment, however, the use of a QSF, and a structured settlement thereafter, is not necessarily preventable. Though some casualty companies refuse to participate in single-claimant QSFs,<sup>379</sup> courts can and have ordered defendants to pay into a QSF even where not stipulated by a settlement.<sup>380</sup> In addition, plaintiffs can and sometimes do attempt to avoid defendants' knowledge of a QSF's use.<sup>381</sup> There are two steps that plaintiffs can take to guard against defendants learning of a QSF's use:<sup>382</sup> creating the QSF out-of-state,<sup>383</sup> and not directing defendants to pay to a QSF.

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379. HINDERT ET AL., *supra* note 90, § 3.08B[7]. Liability insurers sometimes oppose the use of QSFs because they wish to benefit from controlling the structuring of a settlement. McBride E-mail, *supra* note 322.

380. One commentator argues that plaintiffs cannot force defendants to pay into a QSF. HINDERT ET AL., *supra* note 90, § 3.08B[7] (citing *Continental Casualty v. United States*, No. C 02-4891 VRW, C 02-5292 VRW, slip op., 2006 WL 3455055 (N.D. Cal. Nov. 29, 2006) (amended order)). Hindert correctly points to *Continental Casualty v. United States*, where a district court refused to create a QSF because plaintiffs could cite only to regulations, rather than law, empowering the court to do so. *Continental Casualty v. United States*, No. C 02-4891 VRW, C 02-5292 VRW, 2006 WL 3455055, at \*3 (N.D. Cal. Nov. 29, 2006) (amended order) ("As a court of limited jurisdiction this court may not create a qualified settlement account merely because a tax regulation allows the creation of such settlement accounts. Rather, plaintiffs must identify some constitutional or congressional grant of authority providing this court with jurisdiction to create unilaterally qualified settlement accounts."). Thereafter, the court delineated a way that such a QSF could be used with defendant's consent. *Id.* However, other plaintiffs have persuaded courts to order defendants to pay previously agreed settlement amounts into QSFs. Order Granting Motion for Expedited Relief, No. Civ. 06-1153 MCA/WDS (D.N.M. Jan. 17, 2008). Such courts have, in the past, immunized defendants from liability in the event that funds deposited into a QSF are found to be taxable. *E.g., id.* at 1. It appears that some companies are attempting to prevent such a court order by recommending that their settlements specifically disallow the use of QSFs. Peahl & Miller, *supra* note 323, at 19 ("The parties agree that the proceeds shall not be payable into a qualified settlement fund ('QSF'), as defined by 26 U.S.C. § 468B or 26 C.F.R. § 1.468B-1(c)(1). No party shall either agree to or seek to obtain a consent or other court order to have any portion of the proceeds placed into a QSF at any time.").

381. Risk E-mail, *supra* note 303 (stating that he created this tactic and has used it in multiple cases, though declining to describe exactly how).

382. Some in the industry believe that defendants will eventually discover the QSF through the use of a court order. Darer Interview, *supra* note 227; Neff E-mail, Feb. 6, 2009, *supra* note 331. However, as the following text shows, this is not necessarily true. Moreover, even if it was, the defendant might not be able to prevent their payment from being entered into and distributed by a QSF anyway. See *supra* note 381 and accompanying text.

383. The QSF could also be created in the same state, but in a jurisdiction other than where the claim for damages was prosecuted, such as in a probate court that is handling the recovery of damages on the behalf of a minor.

First, plaintiffs can establish a QSF outside of a defendant's purview. Regulations do not require that QSFs be created in the same proceedings, the same court,<sup>384</sup> or even the same state as the tort action.<sup>385</sup> For example, a Florida state court created a QSF for a personal injury action filed in a district court in New Mexico.<sup>386</sup> The Florida court held that its broad authority as a court of general jurisdiction was sufficient to create the QSF.<sup>387</sup> In fact, the only other party Treas. Reg. § 1.468B-1 forces plaintiff to involve is a state entity,<sup>388</sup> which orders and continues to exercise jurisdiction over the fund.<sup>389</sup> This entity could be "the United States, any state . . . territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing."<sup>390</sup> As the treatise on QSFs puts it, "Virtually any federal or state governmental authority willing to do so may order, approve, and take continuing jurisdiction over a QSF."<sup>391</sup> However, QSFs are typically created by courts.<sup>392</sup> By creating the QSF in a faraway jurisdiction, the plaintiff makes it unlikely that the defendant will learn of its existence or use.

Second, plaintiff can direct defendant to pay the lump-sum settlement to a name not typically associated with a QSF. Regulations do not require that defendants' checks be made out to a QSF in order for the monies to be deposited therein.<sup>393</sup> In fact, some courts have created QSFs and ordered that settlement monies paid by defendants to plaintiffs' attorneys be directed into the QSF "regardless of the named

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384. WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 1-9, 2-6.

385. *See* Treas. Reg. § 1.468B-1 (as amended in 2006).

386. *See* Order Establishing the Nuñez Segregated Account and Appointing Administrator, No. 2007-538, 250, 4 (County Court at Law No. 3 of Lubbock County, Texas, Oct. 31, 2007).

387. *Id.* (also holding the venue to be "proper"); Order Granting Motion for Expedited Relief, No. Civ. 06-1153 MCA/WDS, Conclusions of Law 4-5 (D.N.M. Jan. 17, 2008) (holding the Texas court to have competent jurisdiction, and ordering defendants to pay into the created QSF).

388. Practitioners note that judges sometimes want the defense to be involved in the creation of a QSF. Russell E-mail, *supra* note 374.

389. *See* Treas. Reg. § 1.468B-1 (as amended in 2006). A QSF can be created in a state court while the litigation is in federal court, or by probate, bankruptcy, or administrative-type courts. WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 2-6. It can also be created by an arbitration award. *Id.* 2-7.

390. Treas. Reg. § 1.468B-1 (as amended in 2006).

391. WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 1-9 (citing Treas. Reg. § 1.468B-1(c)(1)).

392. *Id.* at 1-11, 2-5.

393. *See* Treas. Reg. § 1.468B-1 (as amended in 2006).

payee.”<sup>394</sup> As courts typically order the establishment of a QSF using a plaintiff’s proposed order verbatim it is not likely difficult to secure such language.<sup>395</sup> If the plaintiff can arrange for such a court order, the defendant may never learn of the QSF’s existence or use.<sup>396</sup>

### C. *Ending the Debate Over Single-Claimant Section 468B Funds*

The use of single-claimant QSFs is limited by the Treasury’s ambiguous position regarding the eligibility of single-claimant QSF payments for the structured settlement subsidy. An increased use of single-claimant QSFs, which would direct structured settlement benefits away from defendants<sup>397</sup> and toward plaintiffs, would likely result from Treasury regulations holding that single-claimant QSFs can make use of structured settlements in the same way as multiple-claimant QSFs. Plaintiffs would therefore likely benefit from regulations formally stating that single-claimant QSF structured settlement payments are eligible for the ordinary structured settlement subsidy. As Part IV.B argued, it is in the interest of public policy to direct the benefits of structuring a settlement away from defendants and their liability insurers, and toward plaintiffs, so long as it does not decrease the number or value of structured settlements. This both maintains the influence of deterrence and augments plaintiffs’ ability to cover their future financial needs.

While it is possible to argue that existing statutory, regulatory, and case law implicitly establish this rule, an explicit statement from the Treasury would prevent those considering the use of single-claimant QSFs from abstaining due to ambiguity.<sup>398</sup> The Treasury maintained the issue as an item in its Priority Guidance Plan from 2004

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394. Order Establishing the Nuñez Segregated Account and Appointing Administrator, No. 2007-538, 250, d (County Court at Law No. 3 of Lubbock County, Texas, Oct. 31, 2007); Order Establishing the Enriquez Settlement Trust and Appointing Administrator, No. 06-CA-242-11-L, d (Fla. Cir. Ct. Seminole Cty. 2008).

395. McBride E-mail, *supra* note 322 (noting that courts may involve defendants if they oppose creation of the QSF).

396. No law or regulation prevents the use of such a strategy. Russell E-mail, *supra* note 374. However, some view the strategy as “not quite legitimate and bad business.” *Id.* The same practitioner does note that it might be a “credible option” where the defendant insists on a lump-sum payment. *Id.*

397. Even some commentators who disagree that defendants regularly minimize costs via structured settlements believe that the use of a QSF to be “inherently superior to structuring with a defendant.” Hindert E-mail, Aug. 17, 2009, *supra* note 302. In addition, such proponents of QSFs argue that they are better for defendants because they eliminate defendants’ “potential future liabilities.” *Id.*

398. Wood, *A Mechanism*, *supra* note 349 (“Although the statute itself seems to suggest that even a single-claimant QSF should work, it is best to steer clear of this controversy until it is resolved.”).

through 2009.<sup>399</sup> While the issue is not currently in the Plan,<sup>400</sup> it is not likely closed.<sup>401</sup> Throughout this time, proponents and opponents of the rule have made recommendations to the Treasury.<sup>402</sup> Internal disagreement in the government has been reported,<sup>403</sup> and though a 2001 article found the issue “clear and unambiguous,”<sup>404</sup> there is also considerable disagreement in the structured settlement industry.<sup>405</sup> Moreover, it has been reported that some in the insurance industry have urged the Treasury not to issue guidance on the subject at all, so

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399. DEPARTMENT OF THE TREASURY, 2008–2009 PRIORITY GUIDANCE PLAN 19 (2008), available at <http://www.irs.gov/pub/irs-il/2008-2009pgp.pdf>; Third Quarterly Update of the 2003–2004 Priority Guidance Plan, Department of the Treasury 23 (Apr. 23, 2004), available at [http://www.irs.gov/pub/irs-utl/2003-2004\\_pgp.pdf](http://www.irs.gov/pub/irs-utl/2003-2004_pgp.pdf). As of 2008, it was reported that Treasury guidance “will not promptly be forthcoming.” HINDERT ET AL., *supra* note 90, § 3.08B[5] (citing NSSTA Letter to Members (July 23, 2004)). It has been written that the delay “has been due to diversions caused by the need for tax rulings on relief funds for natural disasters such as the recent hurricanes, floods and a tsunami, plus the departure of several key people from Treasury and the IRS.” Risk, *Attorney Comments*, *supra* note 225. However, the same commentator has received reports “that the issuance of published guidance on the use of QSFs established for the benefit of a single claimant . . . is near.” *Id.*

400. DEPARTMENT OF THE TREASURY, 2008–2009 PRIORITY GUIDANCE PLAN 19 (2008), available at [http://www.irs.gov/pub/irs-utl/2009\\_-\\_2010\\_priority\\_guidance\\_plan.pdf](http://www.irs.gov/pub/irs-utl/2009_-_2010_priority_guidance_plan.pdf).

401. See generally Jeremy Babener, *Treasury Decides to Pass on Single-Claimant Qualified Settlement Fund Guidance for Now*, N.C. L. WKLY., Dec. 14, 2009, at 14.

402. Letter from Skadden, Arps, Slate, Meagher, & Flom LLP to Pamela F. Olson, Assistant Secretary (Tax Policy), Department of Treasury, and B. John Williams, Chief Counsel, IRS, <http://www.risklawfirm.com/files/Section130-BasicSkaddenLtrwithatch7-7-03.pdf> (June 19, 2003) [hereinafter Skadden Letter] (authored by Fred Goldberg, Former Chief Counsel, IRS (1984–1986), Former Commissioner, IRS (1989–1992), Former Assistant Secretary of the Treasury for Tax Policy (1992), Kenneth Gideon, Former Chief Counsel, IRS (1981–1983), Former Assistant Secretary of the Treasury for Tax Policy (1989–1992), and Jody Brewster, Former Assistant Chief Counsel (Income Tax & Accounting, 1994–1999)); Dewey Ballentine Letter, *supra* note 360; NSSTA Letter, *supra* note 14.

403. Risk, *A Case*, *supra* note 7, at 645; Risk, *Structured Settlements*, *supra* note 19, at 896 n.156; Neff E-mail, Feb. 6, 2009, *supra* note 331.

404. Risk, *Structured Settlements*, *supra* note 19, at 894–95.

405. See Skadden Letter, *supra* note 402; Dewey Ballentine Letter, *supra* note 360; NSSTA Letter, *supra* note 14; ROBERT PE AHL & MICHAEL MILLER, SINGLE-CLAIMANT 468(B) TRUSTS (2007), [http://web.aig.com/2007/lit6458/lit6458\\_AIG468\(B\)%20Presentation\\_v2.PPT](http://web.aig.com/2007/lit6458/lit6458_AIG468(B)%20Presentation_v2.PPT). Robert W. Wood, the author of *Qualified Settlement Funds and Section 468B*, writes, “The Regulations seem to allow the possibility of a single claimant QSF.” WOOD, QUALIFIED SETTLEMENT FUNDS, *supra* note 356, at 1-26. However, he recommends that the use of single-claimant QSFs be avoided because of the uncertain application of the constructive receipt and economic benefit doctrines. See *id.* at 2-40. It is unclear if the economic benefit doctrine applies. *Id.* at 2-54. NSSTA has argued since 1997 that the use of a QSF triggers economic benefit in single-claimant cases. Risk, *Structured Settlements*, *supra* note 19, at 896 (citation omitted); *id.* at 896 n.157.

as to maintain uncertainty.<sup>406</sup> Although the Treasury has not taken a clear position, there is some evidence suggesting that it favors the position of single-claimant QSF proponents.<sup>407</sup>

Those making the case that single-claimant QSFs should not be capable of accessing the structured settlement tax subsidy make four arguments: (1) that the legislation and regulatory structure allowing QSFs was not intended for single-claimant cases, (2) that the use of a single-claimant QSF constitutes economic benefit, (3) that allowing single-claimants to use QSFs will counteract Congress's intention to encourage structured settlements, and (4) that allowing single-claimants to use QSFs will lead to abuses of section 468B. As will be shown, the first two arguments have merit, though are ultimately unpersuasive, while the latter two arguments likely fail outright. As previously discussed, the shifting of structured settlement benefits away from defendants is in the interest of public policy. Thus, the Treasury should issue guidance or regulations holding that single-claimant QSFs can use qualified assignments to structure settlements, accessing the subsidy, in the same manner as multiple-claimant QSFs.

There is significant evidence that section 468B and its regulatory framework were intended for multiple-claimant cases. As noted, section 468B was legislated in the context of mass torts.<sup>408</sup> It appears that the regulatory language that proponents of single-claimant QSFs cite,<sup>409</sup> requiring that section 468B funds be "established to resolve or satisfy *one or more* contested or uncontested claims,"<sup>410</sup> was issued in response to a mass tort related request.<sup>411</sup> Moreover, NSSTA success-

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406. Risk, *A Case*, *supra* note 7, at 679–80.

407. The Chief of the IRS Income Tax and Accounting Division, which is the branch assigned the issuance of the relevant regulation, has been cited as confirming "that economic benefit does not automatically occur simply because a QSF is established ultimately for the benefit of a single plaintiff." Risk, *Attorney Comments*, *supra* note 225 (citing Jeffery G. Mitchell, Branch Chief, I.R.S. Income Tax & Accounting Division, Address at a seminar sponsored by the Society of Settlement Planners (March 9, 2006)). In addition, the IRS held in a non-binding ruling that moneys transferred into four identical single-beneficiary QSFs would not constitute taxable income to the beneficiaries of the funds. I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997) (entirely ignoring the question of economic benefit).

408. See Winslow, *supra* note 360, at 84.

409. Risk, *Structured Settlements*, *supra* note 19, at 895.

410. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006) (emphasis added).

411. T.D. 8459, 1993-8 I.R.B. 6 (1992) ("One commentator requested that the final regulations clarify whether all potential claims must be asserted before a fund, account, or trust satisfies the requirement of § 1.468B-1(c)(2). In response to this comment, the final regulations clarify that even a single claim satisfies this requirement."). Thus, opponents argue that the "one or more" language is meant to allow a QSF to be created for a single, though soon-to-be joined, member of a plaintiff class. NSSTA Letter, *supra* note 14, at 9.

fully lobbied for Rev. Proc. 93-34 specifically to use section 130 qualified assignments in mass tort cases.<sup>412</sup> Thus, opponents of single-claimant QSFs argue, use of section 468B for single-claimant cases is misuse.<sup>413</sup>

However, these intent arguments face three substantive deficiencies. First, even if the original intent of section 468B and the accompanying regulatory framework related to mass tort cases, no prohibition exists against existing law applying to evolving practices and purposes.<sup>414</sup> Secondly, the regulatory “one or more”<sup>415</sup> language cited by proponents of single-claimant QSFs<sup>416</sup> suggests that the Treasury was aware that permanently single-claimant QSFs might follow.<sup>417</sup> After all, the first plaintiff of a class, having requested the creation of a QSF, might never be joined by other plaintiffs.<sup>418</sup> And third, though Treasury regulations disallow many particular liabilities from QSF use, such as worker’s compensation claims, single-claimant cases are not in that list.<sup>419</sup> Thus, proponents of single-claimant QSFs argue, QSFs with any number of claimants can be created without violating section 468B and its regulatory framework.<sup>420</sup>

Those opposed to single-claimant QSFs argue that the economic benefit doctrine applies and is triggered by single-claimant QSF transfers, necessitating a different tax treatment than for multiple-claimant QSFs.<sup>421</sup> Technically, there is no “express override”<sup>422</sup> of the eco-

412. *See id.* at 9 (“In the individual tort claimant situation, there was no such need for guidance because the defendant (or its liability carrier) making the section 130 qualified assignment clearly was ‘a party to the suit or agreement’ under Code 130(c)(1), and hence the claimant in an individual tort situation clearly could avail himself or herself of the section 130 periodic payment mechanism already.”); Dewey Ballentine Letter, *supra* note 360, at 2 (“The sole purpose of Rev. Proc. 93-34 was to permit qualified assignments from section 468B trusts in mass tort situations *where a trust is needed* to accept defendant’s settlement payment and to administer the funds until the individual claims are resolved. . . . Rev. Proc. 93-34 was *not* written to address situations in which a single claimant is involved.”); Dyer Interview, *supra* note 53.

413. *See* Dewey Ballentine Letter, *supra* note 360, at 1–2; NSSTA Letter, *supra* note 14, at 12.

414. It could be argued that such an action would contradict American notions of democracy; however, the Treasury has discretion to regulate.

415. Treas. Reg. § 1.468B-1(c)(2) (as amended in 2006).

416. Risk, *Structured Settlements*, *supra* note 19, at 895.

417. Even assuming that the “one or more” language was meant to directly respond to a mass tort related comment request, the explanation stated, “the final regulations clarify that even a single claim satisfies.” T.D. 8459, 1993-8 I.R.B. 5.

418. *See* Risk, *A Case*, *supra* note 7, at 659 (providing a hypothetical of a building fire where only one victim is identified).

419. Treas. Reg. § 1.468B-1(g) (as amended in 2006).

420. *See, e.g.*, Risk, *Structured Settlements*, *supra* note 19, at 895.

421. Dewey Ballentine Letter, *supra* note 360, attached memo at 3.

conomic benefit doctrine in the Tax Code or regulations for section 130.<sup>423</sup> In fact, the IRS has applied the economic benefit doctrine test in at least one section 468B trust case.<sup>424</sup> Moreover, the IRS has found the economic benefit doctrine to be triggered where personal injury defendant monies are paid into court ordered trusts for holding and future distribution by a “nonadverse party.”<sup>425</sup> Lastly, if a claimant does receive the economic benefit of monies in a QSF, it would be upon the defendant’s novation, and prior to any qualified assignment, which may be exempted from the economic benefit doctrine. Thus, opponents of single-claimant QSFs argue, the economic benefit doctrine applies to transfers of defendant monies to QSFs in single-claimant cases.<sup>426</sup>

However, there is substantial reason to doubt that the economic benefit doctrine applies to such transfers. First, with respect to the cases presented in the preceding paragraph, neither involved section 130. The economic benefit doctrine arguably does not apply to section 130(c).<sup>427</sup> The IRS has held that the 1988 amendment<sup>428</sup> to section 130(c) “was intended to allow assignments of periodic payment obligations without regard to whether the recipient has the current economic benefit of the sum required to produce the periodic payments.”<sup>429</sup> Thus, it is argued that Congress did not intend for the doctrine to apply to single-claimant QSFs using section 130 to structured settlements.<sup>430</sup> And, in fact, the IRS has previously held that money transfers into four QSFs, each with a single beneficiary, did not constitute taxable income to the beneficiaries.<sup>431</sup>

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422. *Id.*

423. *Id.*

424. I.R.S. Priv. Ltr. Rul. 2001-38-006 (Sept. 21, 2001) (finding that the doctrine of economic benefit was not triggered by the use of a section 468B trust).

425. Rev. Rul. 83-25, 1983-1 C.B. 116. Opponents of single-claimant QSFs also point to an IRS determination that personal injury defendant monies used, pursuant to a court order, to purchase five-year certificates of deposit at a savings and loan association in plaintiff’s name, were taxable to plaintiff. Rev. Rul. 76-133, 1976-1 C.B. 34.

426. Dewey Ballentine Letter, *supra* note 360, attached memo at 3.

427. *See Risk, Structured Settlements, supra* note 19, at 895.

428. Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647, § 6079, 102 Stat. 3709 (1988).

429. I.R.S. Priv. Ltr. Rul. 97-03-038 (Jan. 1, 1997).

430. *See Risk, A Case, supra* note 7, at 645 (“Congress did not intend for the judicial doctrine of economic benefit to apply to the facts of a designated settlement fund or qualified settlement fund for the benefit of a single claimant.”).

431. I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997) (ignoring entirely the question of economic benefit); Risk, *Attorney Comments, supra* note 225 (“Obviously, the IRS found that economic benefit did not attach simply because the QSF was established for the benefit of a sole individual.”) (citing I.R.S. Priv. Ltr. Rul. 97-36-032 (Sept. 5, 1997)); *see also* I.R.S. Priv. Ltr. Rul. 2001-38-006 (May 7, 2001) (stating that in the

In addition, section 486B of the Treasury regulations states, “Whether a distribution to a claimant is includible in the claimant’s gross income is generally determined by reference to the claim in respect of which the distribution is made and *as if* the distribution were made directly by the transferor.”<sup>432</sup> Though this may well have been written to secure excludability of claims covered by section 104(a)(2), the “as if” language could be interpreted to suggest that the economic benefit doctrine should apply to the QSF distribution in the same way it applies to qualified assignments, i.e., it would not apply.<sup>433</sup> Lastly, section 468B Treasury regulations also state that money transfers to QSFs to satisfy a liability are generally not included in gross income.<sup>434</sup> Thus, it seems doubtful that the economic benefit doctrine applies to section 468B claimants structuring their settlements under section 130.<sup>435</sup>

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context of a QSF-related decision, “In order for a taxpayer to include an amount in income under the economic benefit doctrine, the amount must be set aside irrevocably, for the taxpayer’s sole benefit, without restrictions or conditions based upon the occurrence of future events.”). It is noteworthy that in Private Letter Ruling 2001-38-006, while the IRS cited reasons why the transfer of monies into a QSF with multiple possible beneficiaries would not constitute economic benefit to such beneficiaries, the IRS failed to list the future occurrence of the settlement between the beneficiaries and the QSF as one of the possible “future events.” I.R.S. Priv. Ltr. Rul. 2001-38-006. Thus, in the single-claimant QSF scenario, the fact that there must be a settlement between the claimant and QSF might not constitute a “future event” that would prevent the claimant from receiving the economic benefit of monies transferred into the relevant QSF. It is important to recognize that, except pursuant to regulations, private letter rulings cannot be used or cited as precedent. I.R.C. § 6110(k)(3) (2006) (Sept. 21, 2001). However, the Supreme Court has stated that, “although the petitioners are not entitled to rely upon unpublished private letter rulings which were not issued specifically to them, such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws.” *Hanover Bank v. Comm’r*, 396 U.S. 672, 686 (1962) (using a private letter ruling as evidence of a particular interpretation’s validity).

432. Treas. Reg. § 1.468B-4 (1992) (emphasis added) (providing, as an example, that if the claim is for a personal injury, it would be excludable under section 104(a)(2)).

433. Nevertheless, opponents argue that even if section 130’s economic benefit immunity is extended to section 468B fund distributions, the doctrine is still triggered by the transfer from the defendant to the fund. See NSSTA Letter, *supra* note 14, at 7 (“The lump sum payment by the defendant has come to rest in the trust in which all of the interests have merged in the claimant and over which the claimant has investment control, before an assignment can ever be made.”).

434. Treas. Reg. § 1.468B-2 (as amended in 1993).

435. One could argue that because a single-claimant QSF administrator is a non-adverse party to the claimant, the claimant has control and thus constructive receipt of the monies within a QSF. However, constructive receipt violation arguments face similar deficiencies to economic benefit arguments, see Part III.D. (observing the non-application of the constructive receipt doctrine to structured settlements), though they are not frequently made. Risk, *Attorney Comments*, *supra* note 225 (“Constructive

If the economic benefit doctrine is held to apply to single-claimant QSFs, it may be triggered when a defendant transfers a lump-sum payment to a single-claimant QSF.<sup>436</sup> It is argued that monies paid into a single-claimant QSF are no different than a lump-sum payment made directly to claimant.<sup>437</sup> Such arguments highlight the lack of adverse interest or material limitation on the QSF funds.<sup>438</sup>

If the economic benefit doctrine were found to apply, this argument would be persuasive.<sup>439</sup> Though proponents of single-claimant

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receipt has not been raised as an issue in whether a single-claimant QSF can make a qualified assignment.”). In addition, while a QSF administrator is a non-adverse party, they are still legally independent of the claimant, having taken a defendant’s place through novation. Thus, the claimant does not truly control the QSF monies.

436. Dewey Ballentine Letter, *supra* note 360, attached memo at 3.

437. NSSTA Letter, *supra* note 14, at 6.

438. *Id.* at 6; Dewey Ballentine Letter, *supra* note 360, at 3. Proponents of single-claimant QSFs argue, “[A]s long as the QSF is established and operated according to Treasury Regulations to ‘resolve or satisfy’ the claim or claims, there must be a future event (the settlement with the QSF), and that [sic] blocks the claimant from having economic benefit in the QSF’s assets.” Risk, *Attorney Comments*, *supra* note 225. Likewise, they point to a previously cited decision defining the triggering elements for economic benefit; money must be placed in an irrevocable fund beyond the reach of the transferring party, in which the beneficiary has vested rights with receipt conditioned only on the passage of time. *Thomas v. United States*, 45 F. Supp. 2d 618, 620 (1999) (citing *Sproul v. Comm’r*, 16 T.C. 244 (1951)), *aff’d*, 194 F.2d 541 (6th Cir. 1952)). However, a QSF clearly is a fund. It is irrevocable. The question is whether it is beyond the reach of a defendant’s or liability insurer’s creditors, and whether the beneficiary’s interest is vested. Proponents of single-claimant QSFs draft the QSF creation documents with language subjecting the fund to all relevant claims against the defendant, see Risk E-mail, *supra* note 303 (stating that he does so), and recommend that others do the same. *Id.* By doing so, it is argued that there is “always a potential that another claimant can surface before the assets of the QSF are distributed.” *Id.* Thus, the QSF monies are within the reach of the transferor’s creditors. *Id.* This argument holds so long as there truly are creditors of the transferor. If not, the contention is not necessarily false, but certainly weakened. As to the claimant’s vested right to the QSF monies, the discussion of whether the QSF administrator is an adverse party becomes infinitely relevant. The single-claimant QSF proponents’ argument may satisfy the technical language of “vested rights to the money, with receipt conditioned only on the passage of time.” *Thomas v. United States*, 45 F. Supp. 2d 618, 620 (1999) (citation omitted); see Risk, *Attorney Comments*, *supra* note 225 (“In a QSF . . . the claimant has absolutely no rights to the QSF’s assets until there is an agreement between the QSF and the claimant.”). However, other courts may use different language, or look to the function of the QSF and hold the defendant’s transfer to give a single claimant such likelihood of receiving the funds that it satisfies the term “vested rights.” *Id.*

439. *Cf. Rev. Rul. 83-25*, 1983-1 C.B. 116, 117 (finding economic benefit where moneys were ordered to be paid into a trust for holding and future distribution to claimant).

QSFs note the independence of QSF administrators from claimants,<sup>440</sup> the non-adversarial nature must be, and is acknowledged.<sup>441</sup>

The third argument opponents of single-claimant QSFs make<sup>442</sup> is that approval by Treasury would counteract the purpose of the 1982 Periodic Payment Settlements Act:<sup>443</sup> incentivizing structured settlements.<sup>444</sup> Use of QSFs by single-claimants will remove the defense from the structured settlement process.<sup>445</sup> Opponents of single-claimant QSFs assert that the defense's stake in that process promotes the use of structured settlements; "The practical reality born of industry experience is that, as a result [of Treasury approval], fewer physical injury cases will be settled on the basis of a structured settlement."<sup>446</sup> In addition, opponents argue, once defendant moneys are paid into a section 468B fund in a single-claimant case, "history shows that with a lump-sum in hand the temptation is likely to be too great in a significant number of cases, such that recoveries are likely to be prematurely dissipated."<sup>447</sup> Thus, because defendants will decreasingly promote structured settlements, and because single-claimant QSFs will often pay lump-sums to their beneficiaries, it is argued that regulations allowing single-claimant QSFs to access the structured settlement subsidy would thwart Congress's attempt to increase the use of structured settlements.

However, the argument that such regulations would result in fewer structured settlements is unpersuasive.<sup>448</sup> In fact, the use of QSFs may increase the use of structured settlements as a consequence of having additional time to consider structured settlement alterna-

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440. See *Risk, A Case*, *supra* note 7, at 661; see also *Risk, Structured Settlements*, *supra* note 19, at 895.

441. See *Risk, A Case*, *supra* note 7, at 657.

442. NSSTA Letter, *supra* note 14, at 1 (Approval "would significantly reduce the use of structured settlements to resolve the claims of physically injured claimants, and would thereby undermine the longstanding legislative policy to promote structured settlements.").

443. Periodic Payment Settlement Tax Act of 1982, Pub. L. No. 97-473, § 101(a), 96 Stat. 2605 (1983).

444. See Part II.C–E.

445. *Risk, Structured Settlements*, *supra* note 19, at 892; NSSTA Letter, *supra* note 14, at 4.

446. NSSTA Letter, *supra* note 14, at 4.

447. *Id.* at 4–5. QSFs do sometimes pay out lump-sums. Staunton E-mail, *supra* note 378; Russell E-mail, *supra* note 374 (noting that QSFs typically involve a structured settlement); Grassini E-mail, *supra* note 322.

448. Wood, *TAX NOTES*, *supra* note 45, at 74 ("Plaintiff brokers and defense brokers alike will still want to sell annuity policies to earn commissions. Whichever type of broker is involved, the broker will surely want an annuity to be purchased.").

tives.<sup>449</sup> Claimants sometimes decline the structured settlement option because they lack the time to understand its complexities, choosing instead the simple form of a lump-sum.<sup>450</sup> The tax subsidy's incentive is not weaker simply because the structuring is done with a QSF rather than a defendant. Secondly, it stands to reason that defendants would still have an incentive to offer a structured settlement option in many single-claimant cases.<sup>451</sup> Defendants or their casualty insurers have access to all of the structured settlement options available to a QSF. Since the creation of a QSF is more costly and complex, a defendant's proposed structured settlement can be more competitive. Third, while defendants may have less incentive to pursue structured settlement negotiations,<sup>452</sup> attorneys specializing in the administration of QSFs would likely encourage the use of single-claimant QSFs. To do so, they would certainly advertise the available tax benefits of structured settlements. Likewise, brokers who profit from selling annuities for structured settlements would also likely promote the option to plaintiffs.

Lastly, opponents of single-claimant QSFs argue that approval of their use would inevitably result in abuse of the section 468B tax entity.<sup>453</sup> It is proffered that tax advisors<sup>454</sup> and single-claimants<sup>455</sup> would attempt to use section 468B funds to improperly defer receipt of income. In doing so, it is argued, some taxpayers will benefit by investing pre-tax dollars.<sup>456</sup> Thus, opponents of single-claimant QSFs assert, Treasury should not allow access to the subsidy.

However, the abuse argument is unpersuasive. Robert W. Wood, author of *Taxation of Damage Awards and Settlement Payments*, and

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449. *Id.*; Russell E-mail, *supra* note 374 (noting the time-factor as the greatest QSF benefit). *Contra* McBride E-mail, *supra* note 322 (stating that the use of a QSF does not encourage the use of structured settlements).

450. Wood, *TAX NOTES*, *supra* note 45, at 74.

451. Some argue that the danger of lump-sum dissipation is no more present when monies are placed in a QSF than during settlement negotiations with a defendant or liability insurer. McBride E-mail, *supra* note 322. This is because in both cases the claimant does not have ready access to monies. *Id.* In both cases, monies will only be transferred upon a settlement agreement. *Id.*

452. In fact, defendants may encourage the use of structured settlements, even if paying a lump-sum. The defendant could insist on a smaller lump-sum payment by arguing that plaintiff has access to the structured settlement tax subsidy if he or she wishes to use it through a QSF. This would detract, however, from any goal of directing more benefits to plaintiffs.

453. *E.g.*, Dewey Ballentine Letter, *supra* note 360, attached memo at 5.

454. NSSTA Letter, *supra* note 14, at 7.

455. Dewey Ballentine Letter, *supra* note 360, attached memo at 5.

456. It is also argued that approval of single-claimant QSFs could result in deferral opportunities in non-physical cases. Dewey Ballentine Letter, *supra* note 360, at 3.

the recently released *Qualified Settlement Funds and Section 468B*,<sup>457</sup> suggests that the dangers of abuse might equally exist for section 468B funds with several claimants.<sup>458</sup> Thus, he argues, the possibility of abuse should not “drive the debate.”<sup>459</sup>

Proponents of single-claimant QSFs argue that the defense opposes guidance approving single-claimant QSFs in order to maintain control.<sup>460</sup> Opponents argue that single-claimant QSFs are used to capture annuity commissions for plaintiff brokers.<sup>461</sup> Because the Treasury has failed to issue guidance in response to requests,<sup>462</sup> there is much debate over the tax risk to claimants and their attorneys of using section single-claimant QSFs.<sup>463</sup> It is time for the Treasury to issue guidance specifically providing that single-claimant QSFs can

457. Wood, *TAXATION OF DAMAGE AWARDS*, *supra* note 306.

458. Wood, *TAX NOTES*, *supra* note 45, at 74.

459. *Id.* Depending on the QSF administrator’s willingness to delay distribution, the abuse hypothesis could prove to be accurate. However, doing so would have downsides; QSF earnings are taxable at the maximum rate for trusts, I.R.C. § 468B(b)(1) (2006), which is currently 39.6%, I.R.C. § 1(e)(2) (2006).

460. Risk, *Structured Settlements*, *supra* note 19, at 892. Through the use of QSFs, defendants would no longer participate in the choosing of annuities for the structured settlement. Risk also argues that the defense would no longer be able to use the tax subsidy as “bargaining leverage.” *Id.*, at 893. However, this argument is less persuasive. Defendants who predict or assume that plaintiff will use the QSF to structure a settlement would likely insist on a lowering of their settlement payment. Neff E-mail, Feb. 23, 2009, *supra* note 32. And, in fact, the possibility of using a QSF is typically introduced early in negotiations. Russell E-mail, *supra* note 374 (noting that the option of a QSF might not be brought up if the attorneys are not familiar with the entity). It would be possible for plaintiff to capture all of the benefits of a structured settlement, and thus for Risk’s argument to bear out, if the defendant never learns of a QSFs use. As discussed in Section V.B., this can and does occur.

461. Wood, *TAX NOTES*, *supra* note 45, at 73. In truth, there is likely merit to the observation that commissions are driving much of the single-claimant QSF debate. *Id.* (“Much of the criticism of the single-claimant QSF, and the abuses to which some argue it is subject, is really hysteria over plaintiffs’ brokers thwarting the structure efforts of defense brokers.”); Wood, *QUALIFIED SETTLEMENT FUNDS*, *supra* note 356, at 2-42; Neff E-mail, Feb. 6, 2009, *supra* note 331. Some in the industry have observed settlement consultants “abus[ing] the entity to grab the commissions for themselves.” Darer Interview, *supra* note 227. In fact, settlement brokers who typically represent defendants or liability insurers sometimes oppose the use of QSFs because of lost commissions. Russell E-mail, *supra* note 374. *See generally* Risk, *A Case*, *supra* note 7.

462. *See generally id.*

463. *See* Wood, *TAX NOTES*, *supra* note 45, at 76; Risk, *Structured Settlements*, *supra* note 19, at 901 (“The risk to the plaintiff’s attorney, therefore, of a legal malpractice claim brought by his or her client for allowing an adversary to handle the structured settlement for the client seems to be far greater than any tax risk claimed by the opponents of the single-claimant QSF.”); Winslow, *supra* note 360, at 83. Some have asked, if attorneys and brokers who use them are so confident in their interpretation of the tax code and regulations, why are they asking for Treasury guidance on the subject? Darer Interview, *supra* note 227.

create structured settlements within the constraints of the tax subsidy, in the same fashion as multiple-claimant QSFs.

*D. An Acceptable Erosion of Tax Doctrines: One Step Further on the Path*

Having recounted and reviewed the available arguments for and against the IRS treating single-claimant QSFs in the same fashion as multiple-claimant QSFs, this Article concludes that doing so is in the best interest of public policy. Far more clearly than factoring, the erosion of tax doctrines for this purpose serves the substantive goal of the legislated structured settlement tax subsidy.

This Article has demonstrated the initial establishment and subsequent deconstruction of the constructive receipt and economic benefit doctrines as applied to structured settlements. At the moment, the IRS faces the next step: whether or not to deem single-claimant QSFs capable of structuring settlements with payments eligible for the tax subsidy. The use of single-claimant QSFs represents yet another level of claimant's control over settlement monies. The claimant essentially accepts the money, and can thereafter decide when and how to use it. This bears resemblance to the revolutionary change in the mid-1990s brought by the factoring transaction. Claimant was given the ability to commit to a structured settlement, but retain the power to sell the future payments at nearly any given time. At first light, it appears that the deconstruction of two tax doctrines violates Congress's original intent, and perhaps more importantly, contravenes the justification of preventing plaintiffs from prematurely dissipating a lump-sum settlement. However, allowing the ability to factor could serve the purpose for which Congress created the structured settlement tax subsidy.

What detractors of factoring fail to observe is that claimants *lose* the tax subsidy upon the sale of their future periodic payments. While the claimant has benefited from receiving the earnings of their preceding periodic payments tax-free, in deciding whether to factor, they must weigh the need for the upfront money against the *incentive of continued subsidy availability*.<sup>464</sup> That continued subsidy is obtained only if the claimant acts in conformance with Congress's encouragement, choosing not to factor. Of course, the high discount rates sometimes incurred may reduce the value that the claimant received from the settlement below that which he or she might have obtained by

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464. The lump-sum payment from the factoring company is received tax-free. I.R.S. Priv. Ltr. Rul. 1999-36-030 (Sept. 10, 1999). However, as the factoring company cannot exclude the periodic payments as the claimant could, it will not compensate the claimant for that value.

taking a lump-sum to begin with. However, the need for money may outweigh the market price.<sup>465</sup> Congress's concern that a claimant might prematurely dissipate lump-sum settlement monies is only reasonable to the extent that it discourages *irresponsible*, rather than *fast* spending. Thus, factoring is not necessarily in direct opposition to Congress's original intent. What is important is that the tax subsidy operates to incentivize the use of structured settlements. Though factoring allows a claimant to sell their future periodic payments, the tax subsidy operates as a continuing incentive not to. Thus, it serves the original purpose of Congress's legislation, while allowing for actions responding to extenuating circumstances. Either way, Congress demonstrated a willingness to bend or break the doctrines of constructive receipt and economic benefit as applied to structured settlements.

Likewise, the single-claimant QSF may violate the relevant tax doctrines, but it maintains, or even bolsters the effectiveness of the tax subsidy. It is true that the transfer of defendant's monies into a single-claimant's QSF gives that claimant substantive control of the money. However, so long as the IRS treats single-claimant QSFs as it does multiple-claimant QSFs, the tax subsidy will incentivize the claimant to create a structured settlement. A claimant can choose not to use one, but he or she could make the same choice during negotiations over a structured settlement with the defendant. In fact, the time provided by the QSF may make the use of a structured settlement more likely. In addition, the use of the QSF may serve to direct a greater percentage of the tax subsidy toward the claimant, rather than the defendant. If true, the incentive to use a structured settlement would be felt more strongly by claimant in a QSF than during plaintiff-defendant negotiations.

Thus, any deconstruction of the constructive receipt and economic benefit doctrines through the use of single-claimant QSFs, when creating structured settlements, does not depart from structured settlement legislative or regulatory history. Moreover, it is consistent with Congress's stated justification for the tax subsidy. In fact, single-claimant QSFs' ability to access the structured settlement subsidy may assist the effectiveness of the subsidy itself.

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465. As noted, some factoring companies charge rates far in excess of the market price. Limitations of such rates, and perhaps increased judicial scrutiny, are likely in the interest of public policy.

## CONCLUSION

This Article has demonstrated that though Congress initially established the structured settlement tax subsidy with the constraints of the economic benefit and constructive receipt doctrines, both have been eroded over many years. And, in fact, that erosion may serve the original purpose of the tax incentive: encouraging the use of structured settlements in order to discourage the irresponsible dissipation of lump-sum settlements.

After Congress passed the legislation in 1982, defendants and their liability insurers began capturing a large portion of structured settlement benefits. This works against public policy by decreasing the cost of risk-taking, and by decreasing plaintiffs' incentive to structure, except upon defendants' request. Directing those benefits away from defendants and toward plaintiffs, so long as doing so does not decrease the use of structured settlements, serves the interests of public policy.

The use of single-claimant qualified settlement funds does just that. By shifting control of the structuring of a settlement into plaintiffs' hands, and by providing more time for plaintiffs to decide whether to structure, single-claimant qualified settlement funds make the use of structured settlements more likely. The lengthened time also increases the probability that the structuring of the settlement will accurately schedule future payments to correspond with future needs. Doing so may decrease the likelihood of later factoring, and thus possible premature dissipation.

For these reasons the IRS should issue guidance stating that single-claimant qualified settlement funds are capable of structuring settlements with the resulting periodic payments being eligible for the structured settlement tax subsidy.

