Structured Settlements: Security and Protection for Injury Victims
Why Structured Settlements should be the cornerstone of any comprehensive settlement plan

By Jason D. Lazarus, J.D., LL.M., MSCC, CSSC

When any physical injury victim recovers money either by settlement or by verdict, the question of the tax treatment of said recovery arises. As long as it is compensation for personal physical injuries it is tax-free under Section 104(a)(2) of the Internal Revenue Code.[1] Section 104(a)(2) of the Internal Revenue Code states that "gross income does not include . . . the amount of any damages received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal injuries or sickness."[2] Section 104(a)(2) gives the personal injury victim two different financial options for their recovery, lump sum or periodic payments.[3]

The first option is to take all of the personal injury recovery in a single lump sum. If this option is selected, the lump sum is not taxable, but once invested, the gains become taxable and the receipt of the money will impact his or her ability to receive public assistance.[4] A lump sum recovery does not provide any spendthrift protection and leaves the recovery at risk for creditor claims, judgments and potential rapid dissipation.[5] The personal injury victim has the burden of managing the money to provide for their future needs be it wage loss or future medical. The second option is receiving "periodic payments" known as a structured settlement[6] instead of a

---

[1] I.R.C. § 104(a)(2) (2007).
[2] *Id.*
[3] *Id.*
[4] *Id.*
[5] Unlike a structured settlement, simply receiving a lump sum does not provide any spendthrift protection as the money can be dissipated rapidly. Similarly, there is no protection from creditor claims like a structured settlement enjoys.
[6] A structured settlement is a single premium fixed annuity used to provide future periodic payments to personal physical injury victims. The interest earned is not taxable under Section 104(a)(2) and a series of revenue rulings that provide the basis for structured settlements.

©Jason D. Lazarus, all rights reserved (2020)

single lump sum payment. A structured settlement's investment gains are never taxed[7], it offers spendthrift protection[8] and the money has enhanced protection against creditor claims as well as judgments.[9] A structured settlement recipient can avoid disqualification from public assistance when a structured settlement is used in conjunction with the appropriate public benefit preservation trust.

If a structured settlement is to be used for someone eligible for needs based public benefits such as Medicaid and/or SSI, it is vitally important that a plan be properly constructed to avoid disqualification. A structured settlement alone will never preserve public benefit eligibility and may in fact cause permanent disqualification when lifetime benefits are involved. For example, in *Sams v. DPW* [10], a Pennsylvania court found that the purchase of a structured settlement as part of a personal injury settlement was a transfer of assets for less than fair market value, causing disqualification from needs-based benefits for the recipient. To avoid this sort of outcome, it is necessary that a structured settlement's payments be irrevocably assigned to a properly created special needs trust. According to a 2006 Social Security Administration letter, "if the beneficiary of a trust which is not a resource for SSI has no right to anticipate, sell or transfer the annuity payments, the payments from a structured settlement annuity that are

---

[7] *See* I.R.C. § 104(a)(2) (2007). *See also* Rev. Rul. 79-220 (1979) (holding recipient may exclude the full amount of the single premium annuity payments received as part of a personal injury settlement from gross income under section 104(a)(2) of the code).

[8] Structured settlements can't be accelerated, deferred, anticipated or encumbered. The payments are made pursuant to the terms of the contract with the life insurance company. Thus, a personal injury victim is protected from spending the money too quickly. However, there are "factoring" companies that will purchase structured settlement annuities and provide a lump sum payment. These transactions are now regulated by IRC 5891 and many states have enacted provisions to protect structured settlement recipients from unfair transactions. IRC 5891 requires a finding that the sale is in the best interest of the annuitant and requires judicial approval. IRC 5891

[9] Many states offer protection by statute for annuities. For example, in Florida, the Florida Statutes provide annuities immunity from legal process as long as they are not set up to defraud creditors. *See generally* § 222.14 Fla. Stat. (2007).

[10] Sams v. Department of Public Welfare, 2013 Pa. Commw. LEXIS 337 (August 21, 2013).

©Jason D. Lazarus, all rights reserved (2020)

irrevocably assigned to an SNT, are not income to the trust beneficiary when paid into the trust."[11] In addition, under the *Sams* decision, payments should begin immediately into the trust. They cannot be deferred, and the death beneficiary of future payments should be the special needs trust so as not to frustrate federal payback requirements.

Given the obligations for personal injury practitioners to advise injury victims about the form of their financial recovery, greater detail about the protections afforded by structured settlements is appropriate. Structured settlements utilizing life insurance annuities as their funding mechanism have been around for four decades. Over half a million injury victims receive benefits from structured settlement annuities. Each year, life insurance companies that provide structured settlements receive more than $6 billion to fund new structured settlement arrangements and an estimated $156 billion has been paid in total to fund structured settlements in force since the seventies.[12] Since 1976, in excess of 880,000 cases were settled using a structured settlement for all or part of the settlement with an average annuity premium of just over $177,000.00.[13]

Structured settlements are utilized in the settlement of tort claims because of the advantages they offer like income tax-free payments[14], fixed low-risk competitive returns, guaranteed lifetime income, no-cost financial management, spendthrift protection, creditor protection and avoidance of guardianship requirements in certain cases. Structured settlements offer the unsophisticated investor the ability to make a onetime simple investment decision that

---

[11] Letter from Nancy Veillon, Associate Commissioner for Income Security Programs to Roger M. Bernstein dated January 1, 2006.

[12] Daniel W. Hindert & Craig H. Ulman, *Transfers of Structured Settlement Payment Rights: What Judges Should Know About Structured Settlement Protection Acts*, 44 NO. 2 JUDGES' J. 19 (2005); *see also* https://s2kmblog.typepad.com/rethinking_structured_set/2017/02/structured-settlement-2016-annuity-sales.html

[13] https://s2kmblog.typepad.com/rethinking_structured_set/2017/02/structured-settlement-2016-annuity-sales.html

[14] *See* I.R.C. §104(a) (2008). *See also* Rev. Rul. 79-220 (July 1979) (payments are income tax-free to injury victim and all subsequent payees)

©Jason D. Lazarus, all rights reserved (2020)

will provide competitive returns with no market risk and no taxation.[15] Similarly, for sophisticated investors they can use the annuity as a funding mechanism for other investments using a dollar cost averaging approach.[16] For the injury victim, a low risk, fixed and income tax free vehicle that can provide guaranteed income is very attractive and appropriate. In addition, a structured settlement can be a tool to pass wealth on to the next generation avoiding income tax on any of the income generated.[17]

Government Oversight of Life Insurance Companies

There are a variety of legal protections offered by structured settlements. A particularly important set of legal protections will be explored in the following paragraphs. First, annuities in general have some significant protections against loss due to insolvency of the life insurance company (the only way to lose money with a fixed annuity). There are several layers of protection against insolvency or in case of insolvency. The first layer of protection is that annuity providers are overseen by state insurance commissions. The second layer of protection is that state law imposes reserve and surplus requirements on life insurance companies. The third layer of protection is that every state has a state guaranty association which guarantees annuities. The final layer of protection is careful selection of the highest quality annuity providers to provide structured settlements.

Life insurance companies are regulated by their domicile state's department of insurance. All the state departments of insurance are part of the National Association of Insurance Commissioners (NAIC). The NAIC is a voluntary organization comprised of the chief insurance

---

[15] 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 (2001).
[16] *Id.*
[17] While structured settlements are income tax-free even to subsequent payees, they are not estate tax free. The present value of the remaining guaranteed payments is includable in the injury victim's gross estate.

©Jason D. Lazarus, all rights reserved (2020)

regulatory officials of the 50 states, the District of Columbia and the five U.S. territories. According to the NAIC, its "overriding objective is to assist state insurance regulators in protecting consumers and helping maintain the financial stability of the insurance industry."[18] The NAIC issued a statement after the recent financial difficulties AIG experienced which stated the following:

> "As a holding company, AIG is a separate, federally regulated legal entity that is distinct and apart from its subsidiary insurers. The subsidiary insurers are governed by state laws designed to protect the interest of policyholders. State insurance regulators are committed to protecting the interest of policyholders and will work closely with AIG management and other regulators to fulfill this commitment.
>
> The No. 1 job of state insurance regulators is to make sure insurance companies operate on a financially sound basis. If needed, we immediately step in if it appears that an insurer will be unable to fulfill the promises made to its policyholders. This includes taking over the management of an insurer though a conservation or rehabilitation order, the goal being to get the insurer back into a strong solvency position.
>
> State regulators have numerous actions they can take to prevent an insurer from failing. Claims from individual policyholders are given the utmost priority over other creditors in these matters – and, in the unlikely event the assets are not enough to cover these claims, there is still another safety net in place to protect consumers: the state guaranty funds. These funds are in place in all states. If an insurance company becomes unable to pay claims, the guaranty fund will provide coverage, subject to certain limits."[19]

As the NAIC pointed out in the foregoing statement, state insurance regulators make sure insurance companies operate on a "financially sound basis." State regulation of insurance companies is the first and primary line of defense against actions by life insurance companies which potentially could lead to insolvency.

In addition to oversight by insurance commissioners and state departments of insurance, state laws require life insurance companies to maintain reserves for every obligation they

[18] NAIC News Release, *Insurance Consumers Protected by Solvency Standards* (Sept. 16, 2008).
[19] *Id.*

©Jason D. Lazarus, all rights reserved (2020)

undertake and regulate the types of investments a life company can make. According to the National Structured Settlement Trade Association (NSSTA), "more than two-thirds of the investments corresponding to a life insurer's required reserves are held in 'investment grade' bonds, with less than five percent in the stock market." On top of reserves, life insurance companies must maintain a surplus of additional funds to meet their future obligations. There are certain asset to liability ratios that are considered healthy. NSSTA points out that the "American Council of Life Insurers, in a recent survey, their members' average surplus ratio actually stood at a factor of over four" while assets of two and a half times liabilities are considered healthy.

State guaranty funds offer a significant line protection to those that have annuities. According to the National Organization of Life & Health Insurance Guaranty Associations (NOLHGA), state life and health guaranty associations are state entities instituted to protect insurance policyholders from insolvent insurance companies. There is a state guaranty association in all fifty states as well as Puerto Rico and the District of Columbia. NOLHGA explains that "[t]he guaranty association cooperates with the commissioner and the receiver in determining whether the company can be rehabilitated or if the failed company should be liquidated and its policies transferred to financially sound insurance companies." Once a "liquidation is ordered, the guaranty association provides coverage to the company's policyholders who are state residents up to the limits specified by state laws."[20]

Obviously care and thought should be given to how to construct a structured settlement plan for an injury victim. Diversification and creating overlapping income streams with different

[20] According to NOLHGA, "when an insurer fails and there is a shortfall of funds needed to meet the obligations to policyholders, state guaranty associations are activated. To amass the funds needed to protect the state's policyholders, insurers doing business in that state are assessed a share of the amount required to meet all covered claims. The amount insurers are assessed is based on the amount of premiums that they collect in that state."

©Jason D. Lazarus, all rights reserved (2020)

companies may be advisable depending on the circumstances. Careful analysis regarding the financial strength of the life insurance companies proposed for an injury victim is also of paramount importance. There are several rating services that evaluate the strength of life insurance companies that offer structured settlements. The primary rating service is A.M. Best, and their top rating is A++. The other important rating service is S&P whose top rating is AAA. While companies rated A+ by A.M. Best or AA by S&P are still excellent companies, depending on risk tolerance of the client and concerns about security, a client might want to go with a company that is A++ and AAA rated. Another option for greater security is diversification whereby multiple top-rated companies are utilized instead of just one highly rated company.

As part of the ratings analysis process, consideration should also be given to the types of investments that a life insurance company makes with its assets. For example, New York Life (rated A++ by A.M. Best and AAA by S&P) has a total of $104 billion invested assets. Bonds make up the largest percentage of their invested assets at 63.6% (of that 69.5% were class 1 highest quality bonds and 23.9% were class 2 higher quality bonds). Mortgages make up a rather small percentage of their invested assets at 8.7% (however 0.0% were classified as “problem mortgages”). In addition, there is a ratio of assets to liabilities measurement that is also important to consider in these turbulent financial times. New York Life’s ratio is very high, meaning they are very well capitalized, as one would expect given their financial ratings.

State Structured Settlement Protection Acts

In addition to the foregoing legal protections, there are state structured settlement protection acts. After the advent of the “factoring” industry in the early 1990s, nearly every state has passed a structured settlement protection act. The acts protect structured settlement recipients from unscrupulous companies that purchase structured settlements. “Factoring”

©Jason D. Lazarus, all rights reserved (2020)

companies, the name commonly used for companies that purchase structured settlements, buy injury victim's payment streams in return for a lump sum payment to the injury victim. The lump sum payment to the injury victim for their future periodic structured settlement annuity payments is typically at a sharp discount with some discount rates being patently unfair.[21] Given the unsophisticated population selling structured settlements, the amount of advertising by factoring companies and past abuses by factoring companies, many states have enacted Structured Settlement Protection Acts and the federal government decided to enact protective legislation in the form of Section 5891[22] of the Internal Revenue Code.

Section 5891 of the Internal Revenue Code requires that all structured settlement factoring transactions be approved by a state court, in accordance with a qualified state statute. Qualified state statutes must make certain baseline findings, including that the transfer is in the best interest of the seller, taking into account the welfare and support of any dependents. Failure to comply with these procedures results in the factoring company paying a punitive excise tax of 40% on the difference between the value of the future payments sold and the amount paid to the person who wanted to sell.

State legislatures began enacting protective legislation, called Structured Settlement Protection Acts, for structured settlements in 1997.[23] While the state Structured Settlement Protection Acts vary, they are based on a model act and most contain similar provisions. While all of the acts mandate court approval of any proposed sale with a best interests finding, most

[21] See *J.G. Wentworth S.S.C. v. Jones, Jefferson Cty*., S.W.3d 309, 315 (Ky. Ct. App. 2000) ("[i]n the four cases here the rate of return to Wentworth varied between 36 and 68 percent per year"); *Windsor-Thomas Group Inc. v. Parker*, 782 So.2d 478 (Fla. 2d DCA 2001) (finding that from "a functional viewpoint, this agreement is a secured promissory note with an annual interest rate of approximately 100 percent.").
[22] I.R.C. §5891 (2008).
[23] Illinois was the first state to enact a structured settlement protection act. Hindert & Ulman, Transfers of Structured Settlement Payment Rights: What Judges Should Know About Structured Settlement Protection Acts, 44 NO. 2 Judges' J. 19 (2005).

©Jason D. Lazarus, all rights reserved (2020)

impose numerous procedural requirements and call for full disclosure of the terms of the transaction. A New York case denied a petition for approval of a "factoring" transaction under the state's structured settlement protection act because of the unfair nature of the deal, lack of a plan for the lump sum to be received and because it was not demonstrated to serve the payee's best interests.[24] Judge Alice Schlesinger explained, in denying the approval of the sale, that "[t]he Act, similar to others nationwide, was designed 'to protect the recipients of long-term structured settlements from being victimized by companies aggressively seeking the acquisition of their rights'."

Other courts that have interpreted the various state acts have found that they are "designed to protect beneficiaries of structured settlements from being taken advantage of by others."[25] The best interests' standard was described by a Pennsylvania court as admitting "the reality that a person's judgment is often clouded by the lure of quick cash; and insures that the public policy considerations involving structured settlements are not usurped by organizations that lure people into assigning future payments for far less than their actual value."[26]

Similarly, cases have held the structured settlement payment acts prevent garnishment of a structured settlement annuity. In a Pennsylvania case, the court held that a creditor's alleged security interest and garnishment of a structured settlement annuity violated the state's Structured Settlement Protection Act.[27] In interpreting the Pennsylvania Structured Settlement Protection Act, the court determined that garnishment was encompassed by the broad meaning of the word "transfer" in the Act.

---

[24] *Petition of 321 Henderson Receivables, L.P. V. Martinez*, 816 N.Y.S.2d 298 (2006) (holding "proposed sale of payee's structured settlement payments was not fair and reasonable and did not serve best interest of payee, and thus could not be approved pursuant to Structured Settlement Protection Act").
[25] *In re Benninger*, 357 B.R. 337 (Bankr. WD. Pa. 2006).
[26] *In re Hilton*, No. 2005-2721, 2005 WL 4171289, 2005 Pa. Dist. & Cnty. Dec. LEXIS 392 (2005).
[27] *In re Benninger*, 357 B.R. 337 (Bankr. WD. Pa. 2006).

©Jason D. Lazarus, all rights reserved (2020)

Another important note relates to anti-assignment provisions found in many structured settlement agreements. Most settlement releases of tort claims where a structured settlement will be implemented contain an anti-assignment provision. This provision typically states that "the periodic payments cannot be accelerated, deferred, increased or decreased by claimant or any payee; nor shall claimant or any payee have the power to sell, mortgage, encumber, or anticipate the periodic payments, or any part thereof, by assignment or otherwise." Most state courts have held that the common law and contract rights relating to these provisions are not superseded by enactment of Structured Settlement Protection Acts.[28] Accordingly, courts have blocked the sale of structured settlements even though they complied with the state act because it would be barred by the anti-assignment clause found in the settlement documents.[29] There is model language that can be inserted into a settlement agreement that would allow for factoring, if desired, but requiring it comply with IRC 5891 and relevant state Structured Settlement Protection Acts.[30]

---

[28] *See generally Rapid Settlements, Ltd. v. Dickerson*, 941 So.2d 1275 (Fla 4th DCA 2006) (holding assignment of payments was prohibited under settlement agreement); *Bobbitt v. Safeco Assigned Benefits Service Co*., 25 Conn. L. Rptr. 324, 41 U.C.C. Rep. Serv. 2d 942 (Conn. Super. Ct. 1999) (holding Structured Settlement Protection Act did not abrogate the anti-assignment provision in the release and enforcing anti-assignment provision); *In re Foreman*, 365 Ill. App. 3d 608, 302 Ill. Dec. 950, 850 N.E.2d 387 (2d Dist. 2006) (rejecting a petition by factoring company under the Illinois Structured Settlement Protection Act for court approval of factoring transaction and holding anti-assignment provision in release prohibited transaction).

[29] *Id.*

[30] Suggested model language is as follows: "None of the Periodic Payments and no rights to or interest in any of the Periodic Payments (all of the foregoing being hereinafter collectively referred to as "Payment Rights") can be accelerated, deferred, increased or decreased by any recipient of any of the Periodic Payments; or sold, assigned, pledged, hypothecated or otherwise transferred or encumbered, either directly or indirectly, unless such sale, assignment, pledge, hypothecation or other transfer or encumbrance (any such transaction being hereinafter referred to as a "Transfer") has been approved in advance in a "Qualified Order" as defined in Section 5891(b)(2) of the Code (a "Qualified Order") and otherwise complies with applicable state law, including without limitation any applicable state structured settlement protection statute. No Claimant or Successor Payee shall have the power to effect any Transfer of Payment Rights except as provided in sub-paragraph (ii) above, and any other purported Transfer of Payment Rights shall be wholly void. If Payment Rights under this Agreement become the subject of a Transfer approved in accordance with sub-paragraph (ii) above the rights of any direct or indirect transferee of such Transfer shall be subject to the terms of this Agreement and any defense or claim in recoupment arising hereunder."

©Jason D. Lazarus, all rights reserved (2020)

Most states impose fines and provide civil remedies for failure to comply with the state structured settlement protection act. Some deem a violation of the statute as a violation of the Unfair Trade Practices and Consumer Protection Law.[31] In addition, there is the 40% excise tax imposed by IRC 5891 for failure to comply with the state structured settlement protection act.[32]

The structured settlement protection acts provide significant protections for structured settlement recipients against factoring transactions and have in some instances prevented the sale of a structured settlement completely. These laws provide an additional protection for structured settlement recipients and illustrate the government's recognition of their value to injury victims.

Protection from Creditors, Bankruptcy and Divorce

Oftentimes the protection that structured settlement annuities are afforded under the law in terms of judgments and creditor claims is overlooked when analyzing whether to implement one. However, this feature is very important for injury victims who need to protect their recovery. Injury victims only get one opportunity to recover compensation for their injuries. If someone who recovers compensation for their injuries is subsequently involved in an accident where they injure someone else or someone is injured on their property, bank accounts and most investments are exposed to claims. In addition, if an injury victim gets into debt and has creditors making claims, their assets could be exposed to these claims.

However, many states have either common law or statutes that protect annuities from legal process. For example, in Florida there is a statute[33] that completely exempts annuities from creditors and judgments. This statute gives injury victims an option to completely protect their

---

[31] *See* 40 P.S. § 4007 (P.A. 2000).
[32] I.R.C. §5891 (2008).
[33] §222.14, Fla. Stat. (2008). Section 222.14 provides: The cash surrender values of life insurance policies issued upon the lives of citizens or residents of the state and the proceeds of annuity contracts issued to citizens or residents of the state, upon whatever form, shall not in any case be liable to attachment, garnishment or legal process in favor of any creditor of the person whose life is so insured or of any creditor of the person who is the beneficiary of such annuity contract, unless the insurance policy or annuity contract was effected for the benefit of such creditor.

©Jason D. Lazarus, all rights reserved (2020)

settlement proceeds from judgments or creditor claims by entering into a structured settlement annuity as part of their settlement. That statute has been interpreted by Florida courts[34] to defeat judgment creditor claims against structured settlement annuities.

In addition, structured settlements offer enhanced protection under the law in case of divorce or bankruptcy. Structured settlements are not owned by the injury victim. Instead, the injury victim is the payee and the life insurance company's assignment company owns the annuity. When a structured settlement is created as part of a settlement an assignment is done. The assignment is done to transfer ownership of the annuity from the purchaser (the defendant) to the life company assignment corporation. The assignment corporation takes on the obligation to make the future periodic payments and purchases an annuity from the annuity issuer. Because of this legal arrangement, structured settlement annuities are not an asset owned by an injury victim. Consequently, it is not an asset that can generally be divided in the case of divorce.[35] The income that it produces can be considered in determining alimony, but the asset itself usually is not divided.[36] Similarly, a structured settlement annuity is not an asset generally reachable in cases of bankruptcy.[37]

---

[34] *See Windsor-Thomas Group Inc. v. Parker*, 782 So.2d 478 (Fla. 2d DCA 2001). Judgment creditor brought action to garnish annuity that funded structured settlement of tort case in favor of the judgment debtor. The *issuer* moved to quash the writ based on the statutory prohibition that annuity contracts are not liable to attachment, garnishment, or legal process in favor of any creditor. The Circuit Court dissolved the writ. Creditor appealed. The District Court of Appeal held that the issuer had standing to raise the statutory prohibition against garnishment.

[35] *See generally Krebs v. Krebs*, 435 N.W.2d 240 (Wis. 1989)
[36] *See generally Ihlenfeldt v. Ihlenfeldt*, 549 N.W.2d 791 (Wis. App. 1996)
[37] *See In re McCollam*, 612 So.2d 572 (Fla. 1993). Annuity was exempt under Florida Statute 222.14 from creditor claims in bankruptcy action. *See also In re Orso*, 283 F.3d 686 (5th Cir. 2002) (holding structured settlement "annuity contracts under which payments were owed came within scope of Louisiana statute exempting such contracts from the claims of creditors"); *In re Belue*, 238 B.R. 218 (S.D. Fla. 1999) (holding "debtor who was named, as payee and intended beneficiary, under annuity purchased by insurance company to fund its obligations under structured settlement agreement was entitled to claim annuity payments as exempt under special Florida exemption for proceeds of any annuity contracts issued to citizens or residents of state . . . ."); *In re Alexander*, 227 B.R. 658 (N.D. TX 1998) (holding structured settlement annuity paid to debtors following the death of their children in automobile accident was entitled to exemption as an annuity under Texas law).

©Jason D. Lazarus, all rights reserved (2020)

In conclusion, structured settlements are an important planning tool for injury victims. Because of their security, tax-free return and general shield against creditor they should be considered as part of a comprehensive settlement plan. Because of the strong financial oversight of life insurance companies by the state departments of insurance, structured settlements are very safe and secure investment vehicles for injury victims. As such, having a structured settlement as the cornerstone of a financial settlement plan, can mean the difference between outliving the settlement or not.

©Jason D. Lazarus, all rights reserved (2020)