Why Qualified Settlement Funds are an Important Tool for Trial Lawyers to Understand

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The following is adapted from [The Art of Settlement](#).

Imagine you just settled a personal injury case for John Doe, who is married to Jane. John has a significant brain injury and there are questions of competency. John was injured on the job but had a product's liability claim which is the part of the case you resolved. He receives both Medicaid and Medicare benefits, but they both have substantial liens along with the workers' compensation carrier. Jane has a consortium claim and there are issues of allocation of the settlement to deal with.

A Medicare Set-Aside may be necessary and a Special Needs Trust is a must to preserve his Medicaid eligibility. A structured settlement is being considered for part of the settlement proceeds. You, as plaintiff counsel, would like to defer taxation of your fees using a deferred compensation mechanism like an attorney fee structure.

What do you do when you settle a case like this where your client is on public assistance, there are allocation issues, settlement planning issues must be addressed, and there are liens to negotiate? Where can you "park" the money while you set up any necessary public benefit preservation trusts, determine allocation of the proceeds, figure out a financial plan, and negotiate the liens? How can you get the money from the defendant immediately without ruining the client's available settlement planning options?

The answers to all these questions is to use a Qualified Settlement Fund (QSF or 468B QSF). Read on to find out more about QSFs and why they're an important tool for personal injury lawyers to understand.

What Is a QSF?

A QSF is a temporary trust established to receive settlement proceeds from a defendant or group of defendants. Its primary purpose is to allocate the monies deposited into it among various claimants and disburse the funds based upon agreement of the parties, or court order (if required). Upon disbursing all of the monies, the QSF ceases to exist.

There are many reasons to use a QSF in a complicated settlement. First and foremost, they are quite easy to establish. There are only three requirements for establishing a QSF. It must be created by a court order with continuing jurisdiction over the QSF. The trust is set up to resolve tort or other legal claims prescribed by the Treasury regulations. Finally, it must be a trust under applicable state law. Any court, with or without jurisdiction over the matter, may sign the order creating the QSF and exert continuing jurisdiction over the trust.

The QSF is a temporary holding tank for the litigation settlement proceeds. It does not exist in perpetuity and is not meant to be a support trust for claimants. Instead, it exists for as long as there are allocation issues between the parties or planning that needs to be done prior to disbursement. It can exist for weeks, months, or years sometimes. There is no limit on the duration of a QSF.

The Benefits of a QSF

A QSF may hold benefits for all parties as it relates to taxes, timing of income, and settlement planning needs. A tax-free structured settlement and a tax-deferred attorney fee structure can be properly created through the use of a QSF. The parties can influence timing of income through the use of a QSF. QSF claimants are typically not taxed on funds in the QSF until those funds are distributed (assuming the damages are taxable). A QSF also gives some extra time and flexibility for claimants to make decisions related to settlement planning issues.

The defendant receives an immediate tax deduction upon contributing the agreed-upon amount to the QSF and is typically permanently released. This is a significant benefit to the defendant as normally they can't claim a deduction until the funds are received by the claimant, which can be delayed in a complicated settlement. An important point is that the tax deduction for the defendant is not impacted by when distributions actually flow out of the QSF.

The tax treatment of QSFs is uncomplicated. A QSF is assigned its own Employer Identification Number from the IRS. A QSF is taxed on its modified gross income (which does not include the initial deposit of money), at a maximum rate of thirty-five percent. Thus, it is taxed on accumulations to the principal from interest or dividends less deductions available, which include administrative expenses.

How It Works

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

In terms of the mechanics, it is easy to establish a QSF. First, a court must be petitioned to establish the QSF. The court is provided with the QSF trust document and an order to establish the trust. Once the order is signed, the defendant is instructed to make a check payable to the QSF and the defendant is given a cash release in return for the payment. The consideration for the release with the defendant is payment into the QSF, thus the consideration recital should reflect payment to the QSF and not the injury victim.

As for timing of distributions from a QSF, that is dependent on the agreement among claimants or as ordered by a court. Upon distribution of funds from the QSF, the trustee will obtain a release from the claimants for the distributions from the QSF evidencing the fact that the distribution resolved or satisfied the claimant's claims against the QSF. Once all funds have been distributed, the QSF ceases to exist.

Remove the Time Crunch

A QSF is a crucial tool for trial lawyers, not least because it also alleviates the time crunch of lien negotiations, allocations, and probate proceedings. The end of a personal injury case is typically a rush to settlement, which I call the "settlement time crunch." However, in the rush, things may be overlooked, or important settlement planning issues may be missed.

A Qualified Settlement Fund can be created to receive the settlement proceeds thereby giving everyone the time necessary to carefully plan for the future. Plaintiff counsel can get his or her fees and costs quickly. The funds are obtained from the defendant, they are released, and the client's settlement dollars can be procured quickly. The liens can be negotiated, allocation decisions can be made, public benefit preservation trusts can be implemented, and settlement planning issues, including structured settlements, can be considered. The attorney's option to structure his or her attorney fees is also preserved. The QSF is an important tool for trial lawyers to consider.

For more advice on advanced QSFs, you can find The Art of Settlement on Amazon.

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