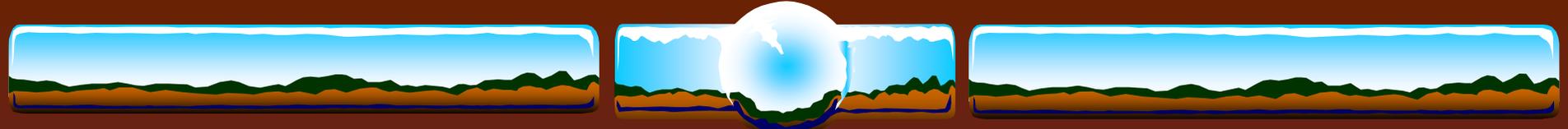


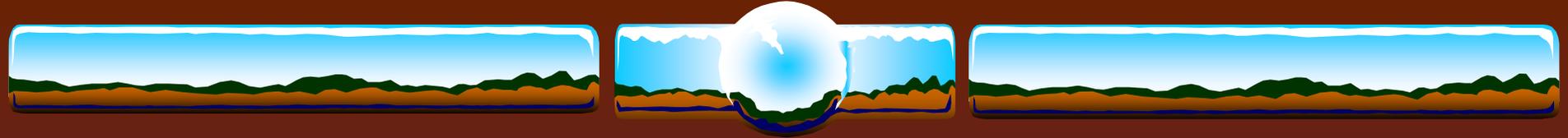
# QSF Best Practices

Richard B. Risk, Jr., Esq.  
Society of Settlement Planners  
Seminar, March 9, 2006  
Washington, DC



# Statutory Requirements to Establish

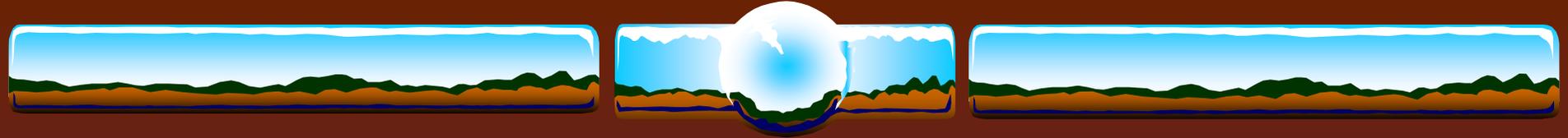
- ❖ Internal Revenue Code (26 USC) § 468B
- ❖ Treasury Regulations (26 CFR) § 1.468B-1(c)
  - ❖ Established pursuant to order by or approval of governmental authority, subject to continuing jurisdiction
  - ❖ To resolve or satisfy one or more contested or uncontested claims arising from an event or related series of events giving rise to at least one claim asserting liability...
  - ❖ Under CERCLA or arising out of tort, breach of contract, violation of law, or as designated by Commissioner of Internal Revenue, and
  - ❖ Fund, account or trust under state law or its assets are otherwise segregated from other assets of transferor



# Selecting a Governmental Authority

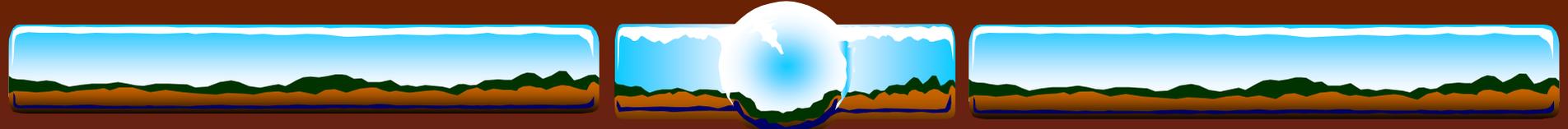
Must be “established pursuant to an order of, or is approved by, the United States, any state (including D.C.), territory, possession, or political subdivision thereof, or any agency or instrumentality (including a court of law) of any of the foregoing and is subject to the continuing jurisdiction of that governmental authority.”

26 CFR § 1.468B-1(c)(1)



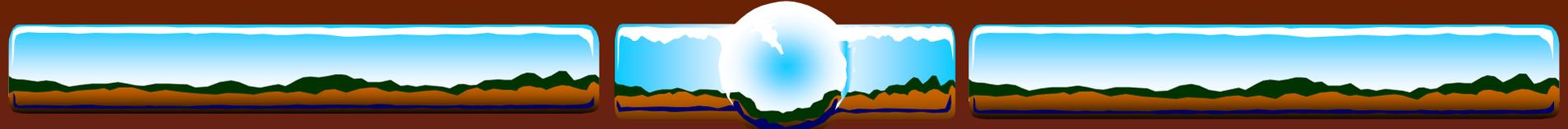
# Handling Opposing Party Objections

- ❖ Defendant or its insurer has no standing to object
- ❖ Public policy give privacy to individuals regarding their personal medical and financial status
- ❖ File petition or motion *ex parte* in trial court or file in another court
- ❖ Provide only QSF tax ID number
- ❖ Make QSF substitute payee



# Role of the Administrator

- ❖ Submits to jurisdiction of court or agency
- ❖ Agent for QSF, which is substitute defendant
- ❖ Becomes a party to the proceedings
- ❖ Trustee, if organized as trust
- ❖ Must exercise independent judgment, even if retained by plaintiff
- ❖ Acts to “resolve or satisfy” claims using QSF assets
- ❖ May promise future payments and assign liability
- ❖ Applies for EIN, sends 1099s and files tax returns



# Funding Administration Costs

- ❖ QSF might generate enough earnings to pay
- ❖ Principal may be used to pay difference
  - ❖ Results in a cost to the beneficiaries
- ❖ Structured settlement producer may pay all or part
  - ❖ Permitted under ABA Model Rules of Prof. Resp., 1.8(f)
  - ❖ Independent judgment
  - ❖ Client must consent
- ❖ Plaintiff's attorney may pay all or part



# Taxation Issues

- ❖ Taxation to payee depends on IRC § 104(a)(2) or other exclusion, i.e., return of property
- ❖ Earnings are taxed at highest federal rate (35%)
- ❖ Earnings also taxed at applicable state rate
- ❖ Expenses, costs, fees directly offset earnings
- ❖ May distribute excess to charity – IRC § 501(c)(3)



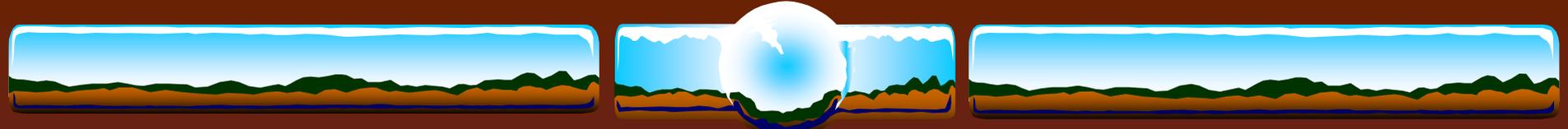
# Court Orders

- ❖ Use to your advantage
  - ❖ Decree no constructive receipt or economic benefit
  - ❖ Decree *ex parte* petition was justified – no effect on defendants
  - ❖ Authorize QSF as substitute payee
  - ❖ Order plaintiffs not to receive funds
- ❖ Recognize that IRS does not always accept state court allocations, etc.
- ❖ Different attitude if federal district court
- ❖ Do not file QSF agreement or settlement agreement between QSF and claimants – for *in camera* review



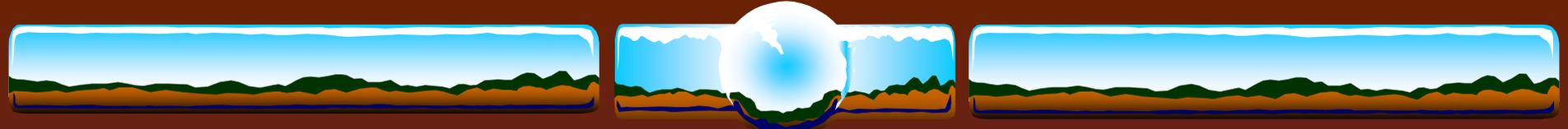
# Constructive Receipt and Economic Benefit Issues

- ❖ Constructive receipt may be avoided
- ❖ Economic benefit is the theory under which the liability insurance industry seeks to prevent a QSF from making section 130 “qualified assignment” when QSF was established for a single claimant
- ❖ Whether CR or EB attaches does not affect the status of the QSF – just whether section 104(a)(2) damages may be structured and assigned
- ❖ Defendant gets tax deduction under IRC § 461(h) regardless of whether funds are taxed to claimant or whether periodic payment liability may be assigned



# Successor QSFs

- ❖ Private rulings suggest that a QSF may be established to receive settlement proceeds from another QSF
- ❖ May be useful in diet drug, asbestos or tobacco cases



# Sequence of Events

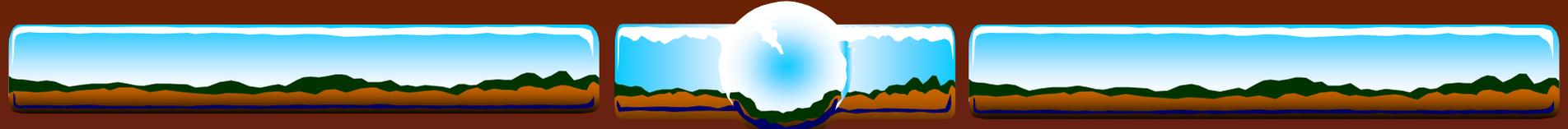
## ❖ Phase One:

- ❖ Establishing QSF
- ❖ Appoint administrator
- ❖ Obtain federal tax ID number (EIN)
- ❖ Settlement between claimants and original defendants
- ❖ Receive funds from transferors

## ❖ Phase Two:

- ❖ Settlement between claimants and QSF
- ❖ May include periodic payments
- ❖ Court approval, if required\*
- ❖ Authorization to distribute\*
- ❖ Issue 1099s and file tax returns

\*Court may authorize distribution in Phase One, subject to settlement agreement, if no duty to protect releasing parties



# Summary

- ❖ This is an effective tool in preserving rights of claimants to make choices
- ❖ Plaintiffs' attorney must understand the risks of allowing the defense to handle the structure
- ❖ Contact an attorney who specializes in QSFs
- ❖ Resources:
  - ❖ QSF Sequence Chart
  - ❖ 23 Va. Tax Rev. 639 (2004)
  - ❖ [www.risklawfirm.com](http://www.risklawfirm.com)