

Structured Settlements Can Help Employment Lawyers

PAYMENTS CAN MINIMIZE TAX LIABILITY, MAXIMIZE SOCIAL SECURITY BENEFITS

By JOHN DARER

Employment settlement recoveries under wrongful termination, sexual harassment, discrimination, failure to promote, Age Discrimination in Employment Act and other employment-related theories of recovery, represent taxable damages. Connecticut lawyers for employers and employees alike can bring an efficient conclusion to employment litigation by using nonqualified structured settlements to effect tax deferral.

Without a structured settlement, a plaintiff settling an employment case faces a significant tax burden in the tax year of the settlement, resulting in a significantly smaller net settlement amount, after applying taxes.

The \$1 million lump-sum employment settlement has a backstory. What a difficult moment it is when the reality sets in for the plaintiff that the \$1 million wrongful termination settlement has been eroded by the plaintiff's attorney fees and taxes to net them only one-third of the settlement amount.

The foundational support for employment structured settlements is strong. A 2008 Private Letter Ruling (PLR 200836009) by the Internal Revenue Service supports the tax deferral, confirming that payments are taxed as received, not funded, and reinforces the use of structured settlements as a settlement planning solution in employment cases. (In its Private Letter Ruling, the IRS cited the seminal 1996 U.S. Court of Appeals for the 11th Circuit case of *Childs v. Commissioner of Internal Revenue*, supporting the "taxed as received" treatment of structured attorney fees to reach its conclusion.)

Dramatically Overpaying

Without a structured settlement, an employer (or the insurer for the employer) risks dramatically overpaying for certain elements of damages. Employers can make all claims dollars count without spending 25 to 35 percent more to account for estimated income taxes.

For example, a 53-year-old plaintiff claims lost pension differential of \$2,000 per month or \$24,000 annually. Plaintiff argues that the dam-

ages should be grossed up to account for a larger lump sum that is needed to produce the loss differential on an after-tax basis using the yield assumptions of the plaintiff's economist. By not offering a lump sum, a defendant or defendant's insurer can offer precisely the amount of the pension differential, starting when the pension would actually be due (e.g., age 65 or 67), funded by a structured settlement with a well-capitalized life insurance company. The plaintiff pays taxes when the payments are due, not when the structured settlement is funded. The resulting savings may be what is necessary to close the gap in negotiating an employment settlement.

What a difficult moment it is when the reality sets in for the plaintiff that the \$1 million wrongful termination settlement has been eroded by the plaintiff's attorney fees and taxes to net them only one-third of the settlement amount.

ing damages for stress-induced ailments does not (1) obtain a medical diagnosis during the underlying dispute; and (2) emphasize diagnosed physical ailments in communications with the defendant, the taxpayer will have difficulty establishing that any resulting damages were received on account of physical injuries or physical sickness. It remains to be seen whether taxpayers who do obtain, and use, medical diagnoses in their pursuit of damages will obtain tax-free treatment when their stress-induced physical ailments are less acute than multiple sclerosis or heart disease."

that may be for a fixed duration or for the lifetime of the plaintiff.

- Periodic payments can be used to help maximize Social Security retirement benefits by providing income that will enable a plaintiff to defer taking Social Security until age 67 or 70, when the amount of benefits will be higher.

- You will receive money from a "job" that you cannot be fired from regardless of future industry downsizing, availability of replacement jobs, stock market volatility, or ups and downs in the real estate market.

- Payments are made by well-capitalized and secure life insurance companies.

Procedural Considerations

Extreme care must be taken to avoid constructive receipt. Employment-structured settlements must be created as part of consideration for the settlement and properly reflected in settlement documentation. Structured settlements cannot be created after constructive or actual receipt has occurred. As always, the devil is in the details. A credentialed structured settlement expert, who is familiar with employment settlements and possesses an active Connecticut insurance producer's license, should be retained.

Certain aspects of employment settlements generally cannot be structured, such as back pay and front pay; however, there is still plenty that can be structured. Structured settlement experts are typically paid a commission or a contingency fee, if a structured settlement is placed.

Physical Injury Claims

Does physical injury ever apply in an employment case? It depends on your brand of "shoe horn."

The U.S. Tax Court decision in *Blackwood v. Commissioner*, T.C. Memo 2012-190, is a reminder that trying to manipulate "emotional/stress-related damages" as physical injury in the hope to get tax-free treatment doesn't always "fit" the IRS' shoes. In "Damages for Stress-Induced Ailments," Lane Powell attorneys Jeremy Babener and Neil Kimmelfield do a nice job of summarizing that "when a taxpayer seek-

ing damages for stress-induced ailments does not (1) obtain a medical diagnosis during the underlying dispute; and (2) emphasize diagnosed physical ailments in communications with the defendant, the taxpayer will have difficulty establishing that any resulting damages were received on account of physical injuries or physical sickness. It remains to be seen whether taxpayers who do obtain, and use, medical diagnoses in their pursuit of damages will obtain tax-free treatment when their stress-induced physical ailments are less acute than multiple sclerosis or heart disease."

Structured Settlement Forms

The so called nonqualified structured settlements used in employment cases come in several forms: (1) a nonqualified assignment with the periodic payment obligation funded with a structured settlement annuity issued by a regulated life insurance company; (2) a nonqualified assignment funded with U.S. Treasury obligations held in a trust, administered by an institutional trustee, created for the exclusive purpose of entering into nonqualified assignments; (3) three-party periodic payment reinsurance; (4)



National Indemnity solution is only available where the defendant is injured.

nonqualified assignment with more esoteric funding instruments.

The reinsurance option is only available where the paying party is insured. Each of these options offers the defendant or insurer for the defendant a complete novation of the claim.

Many plaintiffs and their attorneys prefer an insurance/annuity-backed solution out of familiarity with the brands and the regulatory oversight. Liberty Life Assurance Co. of Boston, which is backed by 114-year-old Liberty Mutual, the country's largest workers' compensation insurer, and National Indemnity Co., a top-rated subsidiary of Berkshire Hathaway, are the primary "manufacturers" used in employment structured settlement solutions. Because it is reinsurance, and reinsurance, by its terms, can only be entered into by another insurer, the

Tax-exempt entities in Connecticut, whose town charters permit, may employ a "buy-and-hold" structured settlement strategy in employment cases, funding the structured settlement and holding the annuity as an asset to back up the liability to pay the plaintiff (instead of using a non-qualified assignment). This may open up more choices of structured settlement annuity issuers. Pursuant to Governmental Accounting Standard Boards accounting rules, however, the tax-exempt entity would have to footnote the contingent liability, however remote on its balance sheet. ■

John Darer is president of 4structures.com, a Stamford-based provider of structured settlements.

Won a Settlement? Congratulations ...



Now put the icing on the cake.

You worked hard to win that settlement. And your client loves you for it.

But imagine if the award jeopardizes public benefits – the ones relied on for medical care?

Help your client create a plan to maintain benefits and preserve settlement proceeds.

Contact us today at (860) 236-7673

- ◆ Settlement planning
- ◆ Special needs trust
- ◆ Tax planning
- ◆ Trust administration
- ◆ Structured settlements
- ◆ Estate planning
- ◆ Conservatorships
- ◆ Medicare Set Aside arrangements
- ◆ Public benefit assistance

CZEPIGA DALY POPE
Estate Planning | Elder Law | Special Needs | Probate
Berlin ◆ Hartford ◆ Simsbury ◆ South Windsor
www.ctseniorlaw.com