



## Delta Group of Settlement Companies

Structured Settlements • Structured Sales

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### FREQUENTLY ASKED QUESTIONS ABOUT STRUCTURED SETTLEMENTS

The Structured Settlement is a unique and tax-advantaged litigation settlement solution that offers benefit in numerous types of actions. A few commonly asked questions about Structured Settlements are presented here.

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- **What is a Structured Settlement?**
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#### ***What is a Structured Settlement?***

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A Structured Settlement is a method of settling a personal injury or workers compensation claim utilizing a stream of periodic payments rather than a traditional lump sum cash payment. The stream of payments are paid to the injured party through a settlement annuity or other funding vehicle purchased by the obligor to fund its obligations under the settlement agreement..

#### ***What are the advantages of Structured Settlements?***

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A Structured Settlement is contractually paid over a period of time and therefore prevents the dissipation of funds by the injured party before the financial needs arising from the injury are met. Further, the entire payments are tax-free to the recipient. This preferential tax treatment for those injured in personal injury and workers compensation case is now a government benefit guaranteed by IRC 5891 and is only available through a properly drawn Structured Settlement transaction.

#### ***What are the limitations of a Structured Settlement?***

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Structured Settlement payments are locked in at the time of settlement. While this is desirable to prevent dissipation of the funds by the injured party, it does not account for an emergency cash

need from the value of the future payments. Fortunately, Congress recently amended the tax code in 2002 under IRC section 5891 allowing the claimant to obtain a cash payment of all or a portion of his/her remaining payments through a "Structured Settlement Factoring" transaction as long as the transaction is approved by the applicable State Court. The factoring companies charge a rather high discount on the value of the future payments -- making this source of funds expensive. Another area of concern is the relatively low Internal Rates of Return vis-à-vis the securities market; however, with the stock market as volatile as it has been recently, the security of a Settlement Annuity now outweighs the potential high side of the investment market.

***When is a Structured Settlement appropriate?***

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A Structured Settlement is most advantageous when the injured party requires or prefers payment of funds over a period of time rather than in a large lump sum for such needs as continuing future medical expenses, replacement of lost or diminished income, and other fixed future income needs. A Structured Settlement is appropriate especially for those people with no experience managing a large lump sum of money and who require a lifetime tax-free income with the security of knowing that the income will always be there.

***Why are the payments tax free?***

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Payments under a worker's compensation claim or claims for ***personal physical injury*** are excludable from gross income of the recipient under Internal Revenue Code (IRC) 104a(1) and (2). If the settlement agreement between the defendant and claimant stipulates a stream of payments funded by the defendant's purchase of a funding vehicle, the Internal Revenue Service (IRS) under Revenue Ruling 79-220 has stated that all of the payments are tax-free to the recipient and his/her estate including the interest income generated by the investment vehicle to fund the future payments. If the claimant receives a lump sum payment from the defendant and purchased the same investment vehicle, he/she will be taxed on the interest income portion of the payments.

***What is a Structured Settlement Agreement?***

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Because of the unique tax benefits available to recipients of a Structured Settlement, the contract that perfects the transaction must include certain rights and restrictions on the parties to the settlement. There are certain basic paragraphs in a standard Structured Settlement agreement that documents the conditions necessary to insure that all of the payments are tax-free to the recipient. In addition, each and every payment must be listed either within the contract or on an addendum to the agreement. A Structured Settlement Agreement must be drawn properly to insure the favorable tax treatment for both the recipient of the benefits and any party that may take an assignment of the contract.

***What is a "Qualified Assignment" Agreement?***

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It is standard practice in the Structured Settlement marketplace that the obligor who enters into a Structured Settlement Agreement, transfer its obligations in the agreement to a third-party assignee. The assumption of this obligation is made in a separate contract called an "Assignment Agreement" or "Assignment and Assumption Agreement". This contract is between the promisor of the underlying structured payments and an "Assignee" that is usually the sister company or the obligor life insurance company, or a wholly owned subsidiary company of the annuity issuer outlined in the underlying settlement agreement. There are two kinds of Assignment Agreements used in settlement of litigated and Workers compensation cases -- A "Qualified Assignment" and a Non-Qualified Assignment.

***What is a "Qualified Assignment"?***

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A "Qualified Assignment" is used in most Structured Settlement transactions. This process was authorized under *The Periodic Payment of Judgment Act of 1984* (IRC 121) which allowed an assignment of the settling defendants obligations under a Structured Settlement Agreement to a third party assignee -- without taxation to the assignee of the internal build up of income in a funding vehicle purchased by the assignee to fund its assumed obligations. The Act limited the transfer to only those payments that fall under IRC 104(a) 1 and 2, for worker's compensation benefits and personal ***physical*** injuries and sickness.

**What is a "Non-Qualified Assignment"?**[back](#)

A Non-Qualified Assignment is one that assumes obligations outlined in a settlement agreement for payments that do not qualify for tax free status under IRC 104(a) 1 and 2. This type of assignment may be used for other types of damages that are not specifically covered under a "Qualified Assignment" such as emotional distress or other personal injuries that are not *physical* in nature. This type of assignment is not available through all life insurers and requires very unique language to protect the payments for tax purposes other than 104(a) 1 and 2 above.

**[See The Allstate / NABCO Settlement Documents Library](#)****What is the advantage to an Assignment?**[back](#)

The advantage of an assignment for the settling defendant is that it removes the defendant/insurer from the risk of insolvency of the life insurer, and for the recipient of the periodic payments, it replaces a relatively small property and casualty company or self insured defendant with a large life insurer as its sole obligor under the underlying Structured Settlement Agreement.

***Can Structured Settlement Payments flow into a Special Needs Trust?*** [back](#)

Under the Omnibus Budget Reconciliation Act of 1993 ("OBRA 93"), the use of a Special Needs Trust (SNT) prevents the amount paid pursuant to a personal injury settlement (either cash or structured) from disqualifying a plaintiff from receiving Supplemental Security Income and Medicaid benefits. Therefore, some settlements may necessitate a SNT, which can be partially funded with a Structured Settlement. In that case the SNT is set up prior to the settlement with the litigants determining the amount of seed monies and periodic payments to be required by the SNT for the future care needs not covered by SSI or Medicaid. The Structured Settlement transaction will allow the periodic payments to flow tax-free into the SNT preventing the taxation of interest income within the SNT.

**[Read more about Special Needs Trusts services from Delta Group](#)*****What is a Medicare Set-Aside Trust?***[back](#)

Medicare has frequently been called upon to provide benefits to those injured in workers compensation claims after the monies paid to the injured party for his future medical benefits are dissipated. Medicare now requires a "set-aside" trust be established prior to settlement of such cases in which the settling defendant will place monies for the benefit of Medicare should the settling claimant be required to use this government benefit in the future. The amounts to be set aside are determined on each individual case by an analysis of the parties to the claim and the local Medicare office.

***What is a Qualified Settlement Fund?***[back](#)

A Qualified Settlement Fund (QSF) is a special court ordered "safe harbor" for funds from one or more settling defendants that allows the defendant to take a complete tax deduction for the entire amount of the settlement monies prior to all of the claims for the monies being determined. The QSF then becomes a new tax-paying entity that enters into Separate Settlement Agreements (including Structured Settlement Agreements) with those that have claims on the monies. IRC 468b, which authorized a QSF, specifically allows an IRC 121 "Qualified Assignment" of the QSF's obligations to make periodic payments under a Structured Settlement.

***What are the advantages of the Qualified Settlement Fund?***[back](#)

The settling defendant and its carrier receive a full cash release. A defendant's carrier does not have an obligation to offer a Structured Settlement to an injured claimant; but it does have an obligation to obtain a release for its policyholder's liability. Therefore, no defendant's carrier should have reason to object to the establishment of a QSF. The administrator of the QSF is usually the representative of the claims to the monies paid into the QSF. This is an advantage to the claimants as it gives them complete control in the choice of the funding vehicles used in any subsequent Structured Settlement or other investment and unlimited time to decide on use of the funds. The QSF also grows through investment by the fiduciary of the fund while waiting for all

factors to be determined prior to final distribution of the funds.

***I'm the claimant's Attorney. Can I structure my fees?***

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Yes! In most cases the claimant attorney can utilize the Settlement Agreement to obtain deferred compensation for fees. And, the schedules of payments – which are outlined in the Settlement Agreement -- do not need to be tied to the claimant's stream of payments. In some cases the attorney can structure his fees even when his client chooses to accept a lump sum cash settlement.

***Why Use Delta Group?***

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Delta Group settlement professionals are dedicated to giving quality, same-day service. We provide **case analysis and innovative funding solutions** for large and small cases alike. As a General Agency, Delta Group represents a large selection of the highest rated life insurance companies and Settlement Trust providers. Many Delta Group specialists are registered settlement advisors who offer a complete analysis of the claimant's future financial needs. We will assist at any settlement conference or mediation as well as offering complete settlement document administrative assistance to the parties to litigation.

**These Questions and Answers are general in nature and the reader should consult his or her own attorney for specific situation.**

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Content herein is informational in nature. Always consult your attorney for specific legal guidance.