## Incorporating a Qualified Settlement Fund into Your Case Resolution Toolkit: buy time for your client, get paid faster, and control your income tax liability

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Litigation can lead to high-pressure situations. Decisions have to be made quickly, especially just as a settlement agreement is close after years of advocating for the client. The litigation may be very complex, especially if there are multiple parties, competing claims, and degrees of liability. After the matter is resolved, the complexities of negotiating and resolving liens and planning for how client(s) receive the proceeds are also complex and can certainly slow payment of fees, especially if you are dealing with a difficult defendant. Representing parties in these matters is ripe with liability if a mistake or oversight is made at any point, so the stakes are high. A Qualified Settlement Fund or (QSF or 468B Trust) is a relatively unknown tool that can provide a great benefit for plaintiffs and the firms who represent them in buying time and control to wade through the settlement complexities without delaying fees.

### What is a Qualified Settlement Fund (QSF)?

A QSF is an account or trust that that allows Plaintiffs and their counsel to fully release Defendants in exchange for a cash-only payment to the QSF. A QSF's primary purpose is to allocate the monies deposited amongst various claimants, and disburses the funds based upon agreement of the parties or court order, if required. The QSF terminates when all the funds have been distributed.

The QSF stems from the Internal Revenue Code §468B[1] and was originally designed for mass torts, but has since grown to be used in a wide variety of matters at any stage of litigation. Prior to the use of QSFs, a Defendant could not take their tax deduction for payment of the claim until the last claimant had been paid. In multidistrict or multiparty litigation, this could be a span of many years. With the implementation of the QSF Defendants could pay into the QSF, be released from liability, take their deduction, and be completely out of the litigation.

For the Plaintiffs, the effect of paying into the QSF is that there is no constructive receipt by the parties, including counsel. This allows time to resolve matters with multiple parties, negotiate liens, address allocation issues, and does not interfere with client(s) public benefits while these issues are resolved. A QSF can be created in as little as 24 hours and there is no time limit on how long it exists. In addition, because there is no constructive receipt, tax-free structured settlements (per IRC § 104(a))[2] can be funded. QSFs can be used to address these issues and take pressure off of Plaintiffs and their counsel.

### The combative opposing counsel

Either Plaintiff or Defense can implement a QSF, and it can be a great tool for removing a difficult opposing counsel once a settlement number has been agreed upon. Though the course of practice we may encounter a difficult personality, or something may have occurred in the past that is influencing how the litigation matter today is negotiated. These interactions may lead to counsel being uncooperative in agreeing to fund structured settlements for the client or attorney fees. One solution is to create a QSF to receive settlement proceeds. After settlement proceeds are paid into the QSF, defense counsel and their claims adjuster is no longer a party to the litigation. The Plaintiff and their counsel will still have all of the settlement planning options available to them they would have had otherwise, control and timing are now with Plaintiff counsel, and a source of frustration eliminated.

## Single Claimant Issue

Using a QSF for single claimant cases has become commonplace today. However, there is some controversy as to whether a QSF can be used in a single claimant case. The basis for the controversy is the assertion by some that money placed into a QSF for a single claimant triggers constructive receipt or economic benefit. If so, the monies would be immediately attributed to the claimant from a tax perspective, thus defeating one of the main purposes of establishing the QSF (control over the timing of income and funding future periodic payments). The IRS, despite many requests over approximately 20 years since the QSF was developed, has refused to comment or clarify this issue.

We are therefore left with the plain meaning of "one or more contested or uncontested claims" in the Treasury Regulations relating to IRC 468B. The regulations state "one or more." The only logical interpretation based upon the meaning of these words would be that it is permissible to establish a QSF for a single claimant. To date, there has never been any negative tax result for the claimant based upon the proper use of a QSF involving a single claimant.

Nevertheless, defendants may raise this issue in an attempt to prevent the creation of a QSF. This typically happens when future periodic payments will be funded from a QSF and relates frequently to issues over control of structured settlement funding. The bottom line is that if the defendant refuses to cooperate with funding a single claimant QSF for these reasons, obtaining a court order to fund the QSF, which can be done in by the trial court. The result for the client is the same benefits discussed throughout the article, however, some insurance companies will not issue policies for structured settlements where there is a single claimant.

## Resolving liens

After prolonged contentious negotiations you have reached an agreeable number with opposing counsel, but there are multiple liens to be resolved which might drastically affect your client's planning options, while the defense wants to pay now. Resolving liens takes time and exposes the firm and the client to risks, such as the ability of the defendant to pay. Corporations and even government entities declare bankruptcy and experience financial downturns, which may result in a non-collectible settlement or judgment. The client's needs could change or the offer may be retracted.

Instead of taking on these risks, create a QSF and get defense out of the litigation. You are then able to control lien resolution process while preserving settlement options for the client that best suits their particular circumstances. Since the funds are not in the firm's IOLTA, it saves the firm from the risk of dealing with the Attorney Grievance Commission if a check bounces, complex reconciliations, and interest being unnecessarily being paid to the state bar. Instead, interest earned is accumulated in the QSF and is attributed to the client (or firm if it is only holding attorney fees).

**Taking time for settlement planning**

After obtaining a great result for your client comes a critical decision time for them: how they receive the litigation proceeds. This time period is also ripe with potential pitfalls for counsel in the exploration and education of the client as their options, the impact on their lives, impact on public benefits, and financial management decisions including how much, if any, to structure. Failure to adequately advise (or seek expert advise) on public benefits, coordination, case management, financial products, estates and trusts and probate ultimately falls upon the litigation firm.

By utilizing a QSF, there is time to engage a team of experts, such as a special needs planning attorney, to help shape a holistic plan for the client. Of particular concern are clients who are incapacitated, have disabilities, or minors, who need more extensive planning and protection. Do they receive public benefits? What is the impact of the litigation recovery? Is a special needs trust appropriate? Who should manage it? Does the client need a conservatorship? Is a settlement protection trust appropriate? What does the client need to protect against the "lottery effect" of the litigation recovery? Should they structure? If so, how much? Do they need an MSA? Do they have a disability determination from Social Security? What types of benefits to they have? These are just some of the questions to be addressed when planning for clients receiving litigation recoveries.

The QSF creates a neutral holding ground while these plans are created. Meanwhile, your fees can be paid immediately or structured, all or in part. A common misconception is that funds held in a client trust account, or IOLTA, protect the client while held by the firm. In fact, once placed in the client trust account, the client constructively receives the funds and they are countable resources for public benefit purposes. By utilizing a QSF, the client has time to get to know the team of advisors and not feel rushed into making decisions. A QSF allows for a more holistic approach to settlement planning by allowing this time for deliberate planning and decision-making. This approach may even enhance your reputation for caring about the client's life after the litigation has ended.

**Multiple defendants**

Resolving disputes with one defendant is complex, and is exponentially compounded the more parties involved. Often, unless the defendants are willing to cooperate, the settlement planning options may be limited. A comprehensive plan cannot be analyzed without all matters being resolved, especially if structured settlements are to be considered. If a QSF is established, each defendant can be released as their matter resolves and their portion is paid into the QSF. Then, after all matters have been resolved and paid into the QSF, one comprehensive legal, financial, and life care plan can be created and implemented from a single source.

### Conflicts among claimants

When multiple claimants are involved in litigation, conflicts may arise among the parties when determining their share of settlement proceeds. Claimants may be friends or family and emotional losses and feelings of entitlement may be difficult to resolve. There may be multiple severely injured parties making claims on limited funds. Other attorneys may represent different factions battling it out for their client's share of the proceeds. The trial lawyer tends to be stuck in the middle of these situations. However, a QSF can allow the trial lawyer to have their fees paid and extricate himself or herself from the situation.

### How a QSF is established and how it works

It is surprisingly easy to establish a QSF. There are only three requirements:

- It must be created by a court order with continuing jurisdiction over the QSF;
- Its purpose must be to resolve or satisfy one or more claims resulting from an event, or related series of events, that has occurred and given rise to at least one claim asserting liability;
- It must be a segregated account or qualify as a trust under state law.

A QSF can be utilized for any matter arising out of a tort, breach of contract, violation of law, environmental matters or any other claims designated in Treasury Regulations. They are frequently used in any matter involving mass torts and catastrophic injury cases due to the benefits afforded to claimants and counsel. However, a QSF **cannot** be used in cases involving workers compensation claims, self-insured health care plans, refund repair or replacement of products used in the course of business, bankruptcy, or anything otherwise excluded by the IRC.

Depending on the experience and resources of counsel used to establish the QSF, it can be done in as little as 24 hours. Typically, a petition is filed with a court of proper jurisdiction to establish the QSF and the court issues an order establishing the QSF. Obtaining this order may take several weeks. Often when litigation is hotly contested and a defendant wants to pay, any delay in facilitating their cooperation and issuance of funds can be fatal. So, working with experienced settlement-planning counsel can take an already successful litigator and add velocity to their ability to resolve matters.

There is specific language that you may consider adding to your release to allow for the proceeds to be paid to the QSF:

> This Release is given in exchange for a payment in the amount of [$ amount] by the Defendant into the [name of QSF]. The receipt for which will be acknowledged, and the funds distributed according the to the terms and conditions of the Order establishing the [name of QSF]. The Defense, or their insurer, must make their settlement payment payable to [name of QSF].

Review the Settlement Agreement and Release to make sure that it states the funds shall be paid or wired to the QSF, and not the Plaintiff or held in the firm's client trust account and a W-9 should reflect the EIN for the QSF, not the law firm or the client. The QSF is much like a trust, and can be actually named anything without affecting the validity of the QSF at all. At times, confidentiality may be a condition or necessary consideration, so even a series of letters and numbers are used that make no sense to anyone outside of the litigation.

Once the QSF has been established and the QSF administrator has received the funds distributions can be made. In terms of timing of distributions from a QSF, that is dependent on the agreement amongst claimants or as ordered by a court. For example, attorney fees can be paid immediately. As for client funds, if the case involves minor or an incapacitated person, the necessary court approvals and probate court proceedings would need to be obtained prior to disbursement of fund from the QSF just like they would if no QSF was involved. The QSF can provide a lump sum payment to counsel or the claimant(s); fund a SNT or MSA, pay liens, fund structured settlements, and pay taxes. If a structured settlement or an attorney fee structure is funded, the QSF replaces the defendant and the transaction is consummated just as any other structured settlement would be if a defendant were involved. 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 is terminated.

More and more litigation firms are using the QSF to control tax liability. There is no time limit to how long the QSF stays in place and remains active as long as it continues to hold assets. The QSF is a helpful tool because income is not recognized until distributed from the trust. So, control is with the firm and the partners decide when to request a distribution and the year in which they recognize the income. A large recovery at the end of the year does not have to create a huge tax liability. Also, firms are looking to create deferred income strategies for retirement, and QSFs are an important tool for implementing these plans and creating options that otherwise may not be accessible.

## Conclusion

After all the hard work of litigation is done, a QSF can be established quickly to allow for control over the settlement process for your client and the firm, and allow time to create a comprehensive holistic plan for the client. Working with a special needs planning attorney early in the process can help mitigate delays and provide expert guidance that will help the firm get paid quickly, support the client through the settlement planning process, and create the trusts or estates needed to manage the funds. By recognizing opportunities to use a QSF, you are adding an incredibly valuable tool to protect your client and eliminate risk of liability to the firm.

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[1] Tax Reform Act of 1986, Pub. L. No. 99-514; I.R.C. §1087(a)(7)(A), 100 Stat. 2085 (1986); I.R.C. §468B.

[2] I.R.C. §104(a). Section 104(a) excludes from gross income personal physical injury recoveries paid in a lump sum or via future periodic payments. It excludes personal injury recoveries under 104(a)(2); Workers' Compensation recoveries at 104(a)(1) and disability recoveries under 104(a)(3).