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Structured Settlement Annuities

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Structured Settlement Annuities
How to 'structure' it right…

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STRUCTURED SETTLEMENT ANNUITY BASICS

What is a structured settlement annuity? A structured settlement is a special type of annuity purchased by the defendant in a personal injury law suit to pay the annuitant (injury victim) future periodic payments. The payments are tax-free under the Internal Revenue Code 104(a)(2) and have certain creditor/judgment protections.

For more than 25 years, the federal government has encouraged injury victims and their dependents to use structured settlements. Structured settlements have also attracted strong support from plaintiff attorneys, state attorneys general, legislators, judges, and disability advocates.

Historically, damages paid because of an injury lawsuit came in the form of a single lump sum. This kind of payment, especially in catastrophic injury cases, often placed the injury victim (or family) in a difficult financial position. With the victim focused on adapting to a new lifestyle, there often was not the time or the experience to manage large sums of money.

That can lead to serious trouble. A person who loses funds intended to cover a lifetime of medical care runs the risk of losing medical care and independence. They also risk exhausting the lump sum and winding up on public assistance.

That's why, in 1982, a bipartisan coalition of legislators in Congress came together to pass legislation that amended the federal tax code. Their action, The Periodic Payment Settlement Act of 1982 (Public Law 97-473), formally recognized and encouraged the use of structured settlements in physical injury cases.

Section 104(a)(2) of the Internal Revenue Code clarifies that the full amount of the structured settlement payments is tax-free to the victim. (By contrast, the investment earnings on a lump sum payment are usually fully taxable.)

Congress also specified in Section 130 the requirements to establish a qualified assignment:

- The assignee assumes the liability from the defendant;
- Both the victim (and his/her attorney) and the defendant agree that the payment schedule cannot be "accelerated, deferred, increased or decreased";
- The payment stream may be excluded from the recipient`s gross income for tax purposes;
- The injury must be a physical sickness or injury; and
- A highly secure funding asset (such as an annuity or U.S. Government obligation) must be used to fund the payments.

In any physical injury case, the plaintiff and defendant negotiate issues such as the victim's medical care and basic living and family needs. Oftentimes, one side (or both) will bring in an expert, such as a structured settlement broker, who provides calculations on the long-term cost of these needs.

When there is agreement on the benefits due to the injury victim (which can happen before, during or after a lawsuit), the defendant will agree to fund a stream of payments that meet these needs. The defendant then assigns this obligation to an experienced third party, such as life insurance company, that funds the damage payments with an annuity. An annuity has been the preferred way of funding because of its pricing, flexibility and lifetime benefits.

…"Structuring" it right means using structured settlement annuities as intended: To benefit the injured party, not the structured settlement annuity broker.

Too often we see a conflict in deciding whether to use a structured settlement or an investment account to fund a trust with the settlement proceeds of a claimant, and we overlook finding the best means of satisfying the <u>needs</u> of the claimant. Quite often this can be accomplished by using a combination of the structured settlement and a lump sum to fund the trust to produce the liquidity and lifetime benefits needed.

<u>ADVANTAGES TO TRUSTEE IN FUNDING TRUSTS WITH STRUCTURED SETTLEMENT ANNUITIES</u>. ***If you are ignoring structured settlements, you are making a fiduciary decision that could be costly to the beneficiary.***

The trustee who fails to consider this option forever loses the beneficiary's opportunity to participate in one of the most significant tax breaks available. The tax savings when structuring either non-taxable or taxable (punitive or non-physical) damages, periodic payments can result in a sizeable difference.

Title search: Structured Settlement Annuities

Also available as part of the eCourse
Choosing a Special Needs Trusts Trustee, Trustee Duties and Responsibilities to Beneficiaries of SNTs, plus Structured Settlement Annuities

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