

# The Sale of Structured Settlements in Minnesota

## Structured Settlements

The term “*structured settlement*” is defined in Minnesota statutes as an arrangement:

- ♦ for the periodic payment of damages for personal injuries established by settlement or judgment in resolution of a tort claim,  
or
- ♦ for periodic payments in settlement of a workers’ compensation claim.

The term “*structured settlement*” is defined in Internal Revenue Code Section 5891(c)(1), as an arrangement which is established by:

- ♦ suit or agreement for the periodic payment of damages which are excludable from the gross income of the recipient under Internal Revenue Code Section 104(a)(2),  
or
- ♦ agreement for the periodic payment of compensation under any workers’ compensation law excludable from the gross income of the recipient under Internal Revenue Code Section 104(a)(1),

under which the periodic payments are of the character described in subparagraphs (A) and (B) of Internal Revenue Code Section 130(c)(2), and are payable:

- ♦ by a person who is a party to the suit or agreement or to the workers’ compensation claim,  
or
- ♦ by a person who has assumed the liability for such periodic payments under a qualified assignment in accordance with Internal Revenue Code Section 130.

## Exclusions From Gross Income Under IRC Section 104(a)(2)

Internal Revenue Code Section 104(a)(2) generally provides that gross income does not include the amount of any damages - other than punitive damages - received (whether by suit or agreement and whether as a lump sum or as periodic payments) on account of **personal physical injuries** or **physical sickness**.

## Exclusions From Gross Income Under IRC Section 104(a)(1)

Internal Revenue Code Section 104(a)(1) generally provides that gross income does not include amounts received under workmen’s compensation acts as compensation for **personal injuries** or **sickness**.

## Structured Settlements - Required Disclosures

Minnesota Statutes identify the disclosures that must be made in a *structured settlement* which is subject to Minnesota law, by providing part as follows:

### *Initial disclosure of structured settlement terms.*

*In negotiating a structured settlement of claims brought by or on behalf of a claimant who is domiciled in this state, the structured settlement obligor shall disclose in writing to the claimant or the claimant's legal representative all of the following information that is not otherwise specified in the structured settlement agreement:*

- (1) *the amounts and due dates of the periodic payments to be made under the structured settlement agreement.*

*In the case of payments that will be subject to periodic percentage increases, the amounts of future payments may be disclosed by identifying the base payment amount, the amount and timing of scheduled increases, and the manner in which increases will be compounded;*

- (2) *the amount of the premium payable to the annuity issuer;*
- (3) *the discounted present value of all periodic payments that are not life-contingent, together with the discount rate used in determining the discounted present value;*
- (4) *the nature and amount of any cost that may be deducted from any of the periodic payments;*
- (5) *where applicable, that any transfer of the periodic payments is prohibited by the terms of the structured settlement and may otherwise be prohibited or restricted under applicable law; and*
- (6) *that any transfer of the periodic payments by the claimant may subject the claimant to serious adverse tax consequences.*

## Structured Settlement Payment Rights

Minnesota Statutes define “*structured settlement payment rights*” as follows:

*"Structured settlement payment rights" means rights to receive periodic payments, including lump-sum payments, under a structured settlement, whether from the settlement obligor or the annuity issuer, where:*

- (1) *the payee or any other interested party is domiciled in the state;*

- (2) *the structured settlement agreement was approved by a court or responsible administrative authority in the state;*
- or*
- (3) *the settled claim was pending before the courts of this state when the parties entered into the structured settlement agreement.*

## **Funding of Structured Settlements**

Structured settlements are often funded by the purchase of a single-premium annuity policy by either the defendant in the litigation, its insurance company, or its assignee.

After the purchase of an annuity policy, the policy is held by whichever party has the contractual obligation to make payments to the injured party under the terms of the structured settlement agreement - which could be either the defendant, its insurance company, or its assignee.

## **Public Policy Reasons for Structured Settlements**

One legitimate public policy for encouraging the use of structured settlements is to ensure that injured parties are provided with a perpetual basis of financial support - in order to reduce the likelihood that such injured parties will request public assistance for their support.

## **Income Tax Treatment of Structured Settlement Payment Rights**

If all of the requirements under IRC Section 104(a)(1) or (2) are satisfied, the full amount of each structured settlement periodic payment - including the interest earned on the annuity contract - will be excludable from the injured party's income.

## **Non-assignability of Structured Settlement Payment Rights**

Structured settlement agreements historically provided that an injured party's rights to receive periodic payments could not be assigned or otherwise transferred to third parties, both:

- ◆ to achieve the recognized public policy underlying such agreements,
- and
- ◆ to meet income tax requirements for one or more of the parties involved.

Nevertheless, unforeseen circumstances can lead to situations where an injured party desires to sell all or part of the periodic payments to which the injured party is entitled in order to raise cash for some legitimate purpose - through a process sometimes referred to as "factoring".

## Structured Settlements “Factoring”

Various financial companies are willing and able to provide immediate cash to the injured party in exchange for the right to receive a certain number of the structured settlement periodic payments.

The cost to the injured party for the opportunity to receive immediate cash instead of a series of periodic payments may be identified as the “discount”, and the process of providing such cash to injured party is often referred to as “discounting”.

However, for the protection of injured parties who may be unsophisticated in financial matters, and for the advancement of the public policy objectives, Minnesota courts or administrative agencies are required to approve in advance all proposed transfers of the right to periodic payments by injured parties.

## Transfers of Structured Settlement Payment Rights

Minnesota Statutes restrict the transfer of “*structured settlement payment rights*” by providing in part as follows:

*No direct or indirect transfer of structured settlement payment rights is effective and no structured settlement obligor or annuity issuer is required to make a payment directly or indirectly to a transferee of structured settlement payment rights unless the transfer has been authorized in advance in a final order of a court of competent jurisdiction or responsible administrative authority, based on the court's or responsible administrative authority's written express findings that:*

- (a) *the transfer complies with the requirements of sections 549.31 to 549.34 and will not contravene other applicable law;*
- (b) *not less than ten days before the date on which the payee first incurred an obligation with respect to the transfer, the transferee has provided to the payee a disclosure statement in bold type, no smaller than 14 points, specifying:*
  - (1) *the amounts and due dates of the structured settlement payments to be transferred;*
  - (2) *the aggregate amount of the payments;*
  - (3) *the discounted present value of the payments, together with the discount rate used in determining the discounted present value;*
  - (4) *the gross amount payable to the payee in exchange for the payments;*
  - (5) *an itemized listing of all brokers' commissions, service charges, application fees, processing fees, closing costs, filing fees, referral fees, administrative fees, legal fees, notary fees, and other commissions, fees,*

*costs, expenses, and charges payable by the payee or deductible from the gross amount otherwise payable to the payee;*

- (6) *the net amount payable to the payee after deduction of all commissions, fees, costs, expenses, and charges described in clause (5);*
  - (7) *the quotient, expressed as a percentage, obtained by dividing the net payment amount by the discounted present value of the payments; and*
  - (8) *the amount of any penalty and the aggregate amount of any liquidated damages, including penalties, payable by the payee in the event of a breach of the transfer agreement by the payee;*
- (c) ***the payee has established that the transfer is in the best interests of the payee and the payee's dependents;***
- (d) ***the payee has received independent professional advice regarding the legal, tax, and financial implications of the transfer;***
- (e) *the transferee has given written notice of the transferee's name, address, and taxpayer identification number to the annuity issuer and the structured settlement obligor and has filed a copy of the notice with the court or responsible administrative authority; and*
- (f) *that the transfer agreement provides that any disputes between the parties will be governed, interpreted, construed, and enforced in accordance with the laws of this state and that the domicile state of the payee is the proper place of venue to bring any cause of action arising out of a breach of the agreement. The transfer agreement must also provide that the parties agree to the jurisdiction of any court of competent jurisdiction located in this state.*

*If the transfer would contravene the terms of the structured settlement, upon the filing of a written objection by any interested party and after considering the objection and any response to it, the court or responsible administrative authority may grant, deny, or impose conditions upon the proposed transfer as the court or responsible administrative authority deems just and proper under the facts and circumstances in accordance with established principles of law.*

*Any order approving a transfer must require that the transferee indemnify the annuity issuer and the structured settlement obligor for any liability including reasonable costs and attorney fees arising from compliance by the issuer or obligor with the order of the court or responsible administrative authority.*

***"Independent professional advice"*** means advice of an **attorney**, certified public accountant, actuary, or other professional adviser:

- (1) *who is engaged by a payee to render advice concerning the **legal, tax, and financial implications** of a transfer of structured settlement payment rights;*
  - (2) *who is not in any manner affiliated with or compensated by the transferee of the transfer;*
- and*
- (3) *whose compensation for providing the advice is not affected by whether a transfer occurs or does not occur.*

At least one Minnesota judicial decision has upheld the statutory prohibition on the professional advisor or attorney representing the injured party / proposed transferor (hereinafter the “Proposed Transferor”), from having a compensation arrangement which is contingent on the proposed transfer being approved by the court.

Therefore, the attorney for the Proposed Transferor cannot represent the Proposed Transferor under a payment plan which will only compensate the attorney if the transaction is approved by the court.

This means that if the attorney for the Proposed Transferor is to be compensated by the Proposed Transferor for providing the required independent professional advice, the attorney must have a right to receive his or her compensation whether or not the proposed transaction is approved by the court.

Since the attorney for the Proposed Transferor must provide the Proposed Transferor with professional advice concerning the **legal, tax, and financial implications of the proposed transfer** of structured settlement payment rights, the process is fairly involved, and will likely require more than several hours of the attorney’s time in order to provide such professional advice.

The Proposed Transferor must also keep in mind that Minnesota courts will likely require that the **best interests** of the Proposed Transferor’s dependents must be considered by the court when deciding whether to approve any proposed transfer of periodic payments rights, in addition to the best interests of the Proposed Transferor.

Therefore, the court may want to make certain that the interests of any spouses or minor children of the Proposed Transferor will be adequately protected before the court will approve the transfer.

A **best interests** determination by the court may involve a broad consideration of the facts, circumstances, and means of support available to the Proposed Transferor and his or her dependents, including:

- ◆ the reasonable preference of the Proposed Transferor in light of the Proposed Transferor's age, mental capacity, maturity level, and stated purpose for the transfer,
  - ◆ whether the structured settlement periodic payments were intended to cover future income loss or medical expenses - in which case the Proposed Transferor may be required to have a means of support independent of the Structured Settlement Payment Rights to meet such obligations,
  - ◆ whether the discount rate offered by the financial company is in line with the market rate for similar transfers - although there is no specified limit on the discount rate for such transactions;
- and
- ◆ whether the Proposed Transferor can meet the financial needs of, and his or her obligations to, the Proposed Transferor's dependents if the transfer is allowed to proceed.

Documents which should be provided to the attorney representing the Proposed Transferor at the time that the attorney is retained by the Proposed Transferor include the following:

1. A copy of the original court order establishing the structured settlement, and the periodic payments identified therein.
2. Copies of all disclosure documents provided to the Proposed Transferor by the defendant or its insurance company just prior to the original court order for the structured settlement.
3. The names and ages of all dependents of the Proposed Transferor.
4. The places of employment and current earning levels for the Proposed Transferor and his or her spouse.
5. An explanation of how any spouse or minor dependents of the Proposed Transferor will be adequately supported if the proposed transfer is approved by the court.
6. An identification of the manner in which the cash funds to be received from the proposed transfer will be used by the Proposed Transferor if such transfer is approved by the court.

The Proposed Transferor may also be required to provide the attorney representing the Proposed Transferor with an up-front cash payment to be used as a deposit towards legal fees to be earned in the representation at the time that the attorney is retained by the Proposed Transferor.

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### **Legal Disclaimer**

Information provided herein is only for general informational and educational purposes. The laws regarding the transfer of structured settlement payment rights involve many complex legal issues. **If you have a specific legal problem about which you are seeking advice, either consult with your own attorney or retain an attorney of your choice.**

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