Kelly Ramsdale is President of Kelly Ramsdale & Associates in Denver, Colorado. She advises plaintiff attorneys and their clients in medical malpractice, wrongful death, products liability, aviation, auto bodily injury, trucking cases, sexual molestation/ assault, civil rights and wrongful termination/age discrimination cases. She travels extensively to not only attend mediations, but to personally meet with the injured parties and their families all over the United States. She has been involved in the US Gymnast sexual assault cases, the Purdue Pharma class action cases, the Columbine High School cases, the 9-11 Victims' Compensation Fund and Pan Am Flight 103 (Lockerbie) cases. She works with many highly renowned firms across the country.

Kelly Ramsdale
& Associates, Inc.

9457 S. University Blvd.
#408
Highlands Ranch, CO 80126
p. 303.996.6600
f. 303.996.6601
toll free 800.550.1665
www.kellyramsdale.com

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You've Won at Trial...

Now what are you going to do with your hard-earned fees?

By Kelly Ramsdale

Many of you are aware that your personal injury clients are allowed to take their settlements in the form of a structure, where all gains grow tax-free. Did you know that you, as their attorney, are allowed to use similar structures for your fees?

Why might an attorney consider structuring fees?

If you've been watching the financial markets lately, you would have to agree that they have seen better times. Recently, the markets had two of the worst days since reopening after the 9-11 attacks. Two of the worst days since 9-11 *in one week!* Financial experts tell you to diversify your investments for just that reason. One investment vehicle most financial planners don't even know exists is an attorney fee structured settlement. It combines tax-deferred gains with a fixed return and it comes with very low risk.

Tax-Deferral. There are many financial vehicles available to savvy investors these days. What would make an attorney stop and consider structuring fees? Actually, there are several reasons. In addition to the same reasons they tell their clients to look at structuring: security, consistent cash flow, inability to blow the money, and competitive rate of return, there is also the tax-deferral opportunity. The payments from attorney fee structures are tax-deferred. In *Childs v. Commissioner*, 103 T.C. 634 (1994), it was determined that the attorney had neither "economic benefit" nor "constructive receipt" of the funds. The attorney is, in essence, agreeing to accept a promise
of future payments, nothing more. A 1099 is issued only in the year payments are received by the attorney. The gains remain tax-deferred, along with the funds used to purchase the structure.

Cash Flow & Savings Concerns. Unfortunately, attorneys are no more insulated from market downturns than anyone else. Structures can provide lifetime income, whether it be immediate or retirement payments, that are completely free from the rigors of the market (once the annuity is locked in), and offer a competitive rate of return.

Many small firms have cash flow crises between settlements. Structures can be set up to pay in to the firm or to the attorney on a monthly basis, beginning 30 days after funding, to ensure smooth operational cash flow. Some attorneys invest a sizeable portion of their fees, but many more have confided in me that they, like their clients, go shopping. They buy cars, boats, motorcycles, expensive watches, and the list goes on. Many attorneys like having guaranteed income, whether for the firm, or for themselves personally. Attorneys use structures to not only help current cash flow at home or at the office, but also
for their children's college funds, their retirement funds, or for guaranteed income to spouses upon their own death.

The process of structuring attorney fees has much in common with the way their clients use the option

The Plaintiff's Process. If you look at how a case progresses from the first demand letter to shaking hands at mediation, it boils down to the defense (or their insurer) having an obligation to make a payment (or in this case periodic payments) to the plaintiff. They, in turn, fund that obligation to make payments via a structured settlement annuity. The plaintiff cannot own the annuity. They may not accelerate, defer, increase, decrease, assign or encumber the payments. The plaintiff merely has the right to collect the future periodic payments.

The benefit plan is chosen by the plaintiff after the case settles. The benefit streams are shopped with all life companies rated A+ or higher and are locked-in. Defense issues a check directly to the assignment company to fund the annuity. The structure terms, inclusive of specific IRS code language, are written into the settlement agreement and release, and court documents (if applicable). If the language is not accurate, the settlement agreement could reflect a cash settlement, which would invite IRS scrutiny down the road. Uniform Qualified Assignment (UQA) documents are also prepared, and include the benefit streams and relevant life company information. This document basically states that the defense or insurer has the obligation to make future periodic payments to the plaintiff, they are assigning that obligation over to the assignment company, and the assignment company accepts the obligation, and will purchase the annuity for the plaintiff. The assignment company is the sole owner of the annuity. The plaintiff, then, simply collects the tax-free payments for the term of the annuity.

The Attorney's Process. When an attorney elects to structure their case, the process is very similar. The benefit streams are chosen after the case settles. The attorney's plan is also shopped with the various markets. Sometimes both the plaintiff and the attorney benefit from placing their structures with two different markets. The structure terms are then written into the settlement agreement and the UQA. There is more specific language to insert related to the structuring of attorney fees that ***must*** be in the settlement documents. *(It is important to keep in mind that the attorney is still able to structure his or her fees even if the plaintiff chooses not to.)* Defense issues a check directly to the assignment company to fund the annuity. The attorney also may not own, accelerate, defer, increase, decrease, assign or encumber the payments. They merely have the right to collect the future tax-deferred periodic payments.

Continued...

Defense's cooperation is required on both plaintiff and attorney fee structures in most circumstances. They not only have to agree to issue checks to the life company(s), but they must also sign all relevant documents. Remember, it is ***their*** obligation that they are funding via the structured settlement annuity and ***their*** assignment of the obligation.

Although it isn't required, it is a good idea for attorneys to include language in their contingent fee agreements that would reserve their right to structure some or all of any fees they receive.

Verdict v. Settlement. It is important to keep in mind that neither the plaintiff nor the plaintiff attorney may have either constructive receipt or economic benefit of the funds in order to structure. The plaintiff and the plaintiff attorney are said to have constructive receipt if the funds are paid without "substantial limitations or restrictions." They have economic benefit if the funds they receive are "unconditionally and irrevocably paid… for the taxpayer's sole benefit." (Sproull v. Commissioner, 16 T.C. 244, 247 (1961)) A judgment would trigger both and a structure would not be an option, ***unless*** the case is in the appeal window. If a Notice of Appeal Pending has been filed, there is enough uncertainty as to the terms and conditions of the plaintiff and the attorney receiving any funds, to make a structure possible.

Luckily, when the plaintiff wins at trial, the defense oftentimes appeals anyway, bringing the case back to settlement negotiations. If the case settles at this point, the structure would work as if no judgment ever took place.

Risks. Risks for both plaintiff and attorney are exactly the same. The only way they do not receive their payments would be for the life insurance company that makes the payments to become insolvent or otherwise not be able to make the payments. Structures are not based on the day-to-day fluctuations of the open market. When the market declines, the structure payments remain the same. For plaintiff and attorney both, whatever they would put into fixed income investments, structures are an unbeatable option.

Additional benefits of attorney fee structures

Joint & Survivor. Plaintiffs may choose a benefit stream that will pay as long as they or their spouse lives. Several life companies now extend this option to attorneys and their spouses.

Rated Age Benefit. If the plaintiff has any chronic conditions or major injuries, they may receive special medical underwriting from the life companies. The resulting "rated age" allows them to basically get a discount on any lifetime benefit streams because the life company is willing to take the risk that the plaintiff will live a shorter time, therefore requiring them to pay out for a shorter time. This allows the rate of return to increase, depending on the seriousness of the health condition. Attorneys may also take advantage of this benefit booster. Attorneys who may be having difficulty in obtaining reasonably priced whole life policies may find structures a great option because of both the medical underwriting and the option to include their spouse in their structure for guaranteed income for life.

Beneficiary Designation. The plaintiff retains one of the rights of ownership, in that they may designate a beneficiary and may change it as often as they wish. Some life companies do allow attorneys to change beneficiaries, but it is often advisable for attorneys to designate their estates.

The tax treatment of a structured settlement follows to the beneficiary, making structures a useful tool in estate planning. In any case, consultation with a tax advisor and/or estate planner is highly recommended.

It may be time to look into structuring an attorney fee of your own!

Whether your needs are guaranteed cash flow for the firm, tax deferral because you've had a good year, college funds for your children, or simply a guaranteed retirement income, structures can really make sense. You might just be kicking yourself for not looking into it sooner. Don't you give Uncle Sam enough?

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