

# A Structured Settlement May Not Be The Best Option

By: Bernard L. Gluckstein, Q.C.  
*Gluckstein & Associates*

## A Structured Settlement May Not Be The Best Option

You have just settled a personal injury claim for an amount intended to be the sole source of income for the rest of your client's life. Your work as counsel and advisor is not complete, because your client has asked you how the settlement funds will last for your client's life and what are the tax ramifications of the settlement. As a prudent solicitor, you provide your clients with some names of trusted financial advisors who can plan your client's future. However, before you close your file and hand your client's future to a financial advisor, there are some basic concepts that are worth explaining to your client, so that they have the confidence to make decisions about their financial future. The options have increasingly been to accept a structured settlement with periodic payments to avoid tax consequences, but the recent decision of [\*Chesher v. Monaghan\* \(2000\), 48 O.R. \(3d\) 451 \(C.A.\)](#) has indicated that a structured settlement may not always be the most prudent option for a plaintiff. The court of appeal found in this malpractice case that the injured plaintiff was properly entitled to a lump-sum award instead of a structured settlement as presented by the insurer. While the structure as presented was indexed to inflation and saved the plaintiff taxes, it was found to be too inflexible and limited the injured plaintiff in his plans for the future. Secondly, the insurer would have also received a substantial discount by purchasing a structure rather than paying a lump sum, and the surplus capital was not passed on to the plaintiff. Finally, the court of appeal opined that the plaintiff would lose his ability to protect his wife and children because his capital would remain in the hands of the insurer after the guarantee period elapsed. Thus, there are several situations where it may be in your client's best interest to negotiate for a lump sum payout over a structured settlement.

In establishing the best plan for a client to consider for the utilization of their settlement funds, the primary consideration is the client's financial, medical and family situation. Within that realm, find out if your client has any high interest debts, such as a mortgage, that can be paid from this settlement. Any plan that is implemented should, as best as possible, provide for as many of the contingencies that may arise. Settlement solutions based on one financial product are inherently limited in their scope, and therefore successful plaintiffs should consider various forms of investment plans, before agreeing to a plan. For any given client a number of different settlement plans will be successful, each one of which has its own implied cost and corresponding benefit. The arguments in favour of, and benefits derived by placing the funds into a structured settlement annuity have been well promoted.

### Pros and Cons

The prevalence of structured settlement annuities has emerged because of the following three benefits structured annuities provide: spendthrift protection; a guaranteed payment stream including the possible provision for lump-sum payments at pre-arranged points in time; and a modest income tax benefit that allows the interest component of the cash flow to be tax free in the plaintiff's hands. However, structured settlements do not provide any flexibility once agreed to, and the plaintiff and/ or the plaintiff's estate relinquish any rights to the capital once the premium is paid to the annuity underwriter. In order to avoid

tax, a plaintiff must give up ownership of their settlement capital. This is a very expensive cost and it should be compared with the cost and impact of volatility in a diversified investment portfolio, i.e. the assumption of greater risk and the opportunity for a higher return. If a plaintiff views the investment of their settlement as though it were a privately funded pension plan intended to replace their income, and understands the imperative need to avoid excessive consumption of the capital, the settlement has a great potential to provide the intended cash flow and additional distributions without sacrificing the plaintiff's ownership of the capital. By looking beyond structured settlements, a plaintiff can establish a tax-efficient plan that provides product choice, a flexible payment schedule and the opportunity to leave an estate.

Paramount to the success of a diversified investment plan is a relationship with an experienced investment advisor knowledgeable in working with successful plaintiffs with structured settlements and diversified investment plans. One of the biggest areas of concern counsel has presented is the impact of tax on the long-term viability of a settlement. Obviously, tax is an important consideration; however, tax is not as pertinent an issue as it is made out to be. Income on settlements for infants is tax free to age 21; for all those above age 21, taxes are a legitimate issue of concern. If a settlement investment plan is properly designed and sufficient consideration is given to the potential tax costs of the plan, a payment schedule can be established that will provide or the perpetual payment of income, including an annual allowance for the payment of tax. Moreover, if the court believes the client will be better off with an alternative plan for the investment of the funds, an argument before the court to permit a gross-up of the quantum of the tax can be successful.

In cases where a plaintiff is no longer able to work and the plaintiff's sole source of future income is from the settlement, that person is presumably in a very low tax bracket. The plaintiff will most likely significantly reduce the taxes they are obliged to pay after deducting the year's basic exemption and any of the following if applicable: the disability tax credit, the tax deductible medical or attendant care costs, capital gains tax exemptions and the deductions for the services of professional accountants and investment managers. Moreover, recent changes to the Canadian tax regime, which include full indexation of the tax brackets, a reduction of the capital gains inclusion rate and proposals to increase the year's basic exemption, will further reduce the impact of tax on a settlement and require plaintiffs to carefully consider the tax-free benefit of the structure versus the termination of their interest in the capital.

### **Conclusion**

Unless the plaintiff is suffering from a mental disability or has sustained a brain injury that affects their ability to handle financial matters, it is prudent for the lawyer to consult with a financial planner to explore other possible options that may be more suitable for the client.

CEG, Financial aspects of this article were provided by Rob Tick, Investment advisor, BMO Nesbitt Burns. Insurance products are sold through [BMO Nesbitt Burns Financial Services Inc.](#)