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How To Create More Value In Employment Mediation

When Congress decided to include, as gross income, settlements made for "non-physical" injury torts, it reduced the value of such settlements by up to 45 percent. This has been particularly devastating in employment cases, where emotional-distress recoveries often helped the employee transition into a new employment situation. Now that those recoveries are taxable, it has been difficult for practitioners to find ways to create more value out of a settlement, aside from getting the defendant to pay more money.

Several ways exist to create more value to the employee when dealing with settlement dollars:

Structured settlement. Perhaps the least utilized but most potent source of assistance to the employee is the structured settlement. This is basically an annuity that is purchased by the employer and designed to pay the employee over the course of months or years a certain sum. That sum grows depending upon the length of the annuity.

The primary value in this approach is that the employee defers taxes on the settlement funds until they are actually received, as opposed to the year that the settlement takes place.

Before the employee receives the money, arrangements are made with a structured-settlement broker, who shops the life-insurance market in order to retain an annuity company to purchase an insurance product from a highly rated insurer.

Several companies now will allow a non-qualified assignment of ownership of the annuity. This means that the employer no longer has to own the annuity but simply has to pay the money to an insurance company, which then will make periodic payments to the plaintiff based on the amount of the settlement. The value to the employee is that they have the security of a guaranteed stream of payments backed by an annuity from a highly rated life insurance company.

The employee may pay fewer taxes on periodic payments, as opposed to the taxes that they would owe on a lump-sum settlement. The rate of return is secured and no management fees are involved.

By way of example, if an employee, who alleged sex discrimination in the workplace, settled a case for $100,000, the numbers would be something like the following: Attorney fees at 40 percent would equal $40,000; federal income tax at 27 percent would equal $27,000; the net to the plaintiff would be $33,000. If part of the settlement were structured over a 10-year period, then the tax to the employee would be $15,000, which is based upon 15 percent of the value of the total settlement over 10 years. The plaintiff would pay tax only based upon the amount that he or she received each year. Since the plaintiff's taxable income likely would be significantly more during the year that the settlement was reached, by spreading that out over a period of time, the tax rate also is reduced because the income is significantly less. The employee would realize approximately 45 percent of the settlement, or $45,000. The employee defers the income tax at a lower rate, while creating a secure stream of income that assists with other financial needs.

The considerations that would justify a structured settlement include whether the employee:

- Actually needs the cash up front or can afford to defer income.
- Might be interested in a retirement-type plan that can be set up at the time of the settlement.
- Has any other future needs, such as a college fund, mortgage or other long-term commitment that would benefit from a periodic payment plan.
- Has a "lottery ticket" mentality about the case.
- Has counsel that can craft a physical-injury component.
- Has long- and short-term goals that fit a structured settlement.

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