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Settlements and Judgments Policy

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Executive Summary

The following policy applies to all Commonwealth departments processing settlements and judgments, including agencies, subdivisions, offices, boards, commissions or institutions of the executive, judicial, and legislative branches of the Commonwealth and constitutional offices.

A settlement or judgment results from a formal claim (grievance, complaint, or lawsuit) against the Commonwealth that results in either a settlement agreement or a court or administrative award, order, or judgment. Settlements and judgments do not include collective bargaining agreement increases or other routine payroll corrections of errors or adjustments. Departments may not process payments or adjustments for a settlement, judgment, or administrative award as a routine payroll entry, but must follow this policy to ensure appropriate tax reporting, withholdings, and funding.

The Office of the Comptroller (CTR) is responsible for ensuring that settlements and judgments are paid with legally available funds, consistent with 815 CMR 5.10, and for the appropriate tax reporting and withholding to the Internal Revenue Service (IRS) and the Department of Revenue (DOR).

Department heads are also required to annually complete CTR's Internal Control Certification. CTR may also conduct periodic interviews and desk reviews to verify a department's compliance with this policy.

Policy Scope

A "claim," as defined by 815 CMR 5.0, is "any demand by any person for damages to compensate an injury or wrong allegedly suffered, including but not limited to personal injury, violation of civil rights, breach of contract, failure to comply with contract bidding laws, incorrect or improper personnel determinations regarding pay, promotion or discipline, failure to comply with statutory or constitutional provisions applicable to employment, and eminent domain taking damages, including any attorneys' fees and interest associated with these claims." Tort claims under M.G.L. c. 258 are handled differently than other types of settlements and judgments. Please refer to the CTR Liability Management and Reduction Fund – Tort Claim Policy for information about such claims.

Types of Claims

Employment-Related Claims

An employment-related claim includes any claim, grievance, lawsuit or any other dispute filed against a department by a current or former employee which arose out of the employment relationship. Employment-related claims that require a payment to the employee outside of the normal course of business must be reviewed by CTR prior to payment.

For a claim to be considered back pay, the settlement or judgment language must identify a specific amount as back pay (lost wages, salary replacement, etc.). Back pay must reflect a calculation based upon a number of days or hours, or incremental salary increases of salary being paid, minus any unemployment payments, workers compensation, disability payments or other salary paid from other sources if the employee was off the payroll during the period being compensated for back pay. If other damages are included as part of a back pay award amount (such as overtime, front pay, emotional distress) the entire amount must be treated as a lump sum award and not back pay.

The requirement that tax Form W-2 be issued for current and former employees applies when all or some part of the payment to a current or former employee could be considered wages. If it is clear that no part of the settlement could be considered wages, for instance if a settlement designates the entire payment as emotional distress damages, CTR can issue a Form 1099.

Non-monetary settlements should not be submitted to CTR for review. This includes settlements such as: putting an employee on a paid leave of absence; adjusting leave balances; prospective raise in salary; or a termination agreement that does not involve a lump sum payment. For information about what constitutes a monetary settlement, please see page 6 below.

Administrative Claims

When an administrative claim, such as a union employee grievance filed with the department or a claim against a department or its staff, is filed in an administrative forum (i.e., MCAD, EEOC), the department is responsible for defending this claim using either in-house counsel, the Human Resources Division/Office of Employee Relations (employment claims), or by hiring outside counsel in compliance with M.G.L. c. 30, § 65, 801 CMR 21.00 and the Expenditure Classification Handbook. (See Legal Fees and Costs section below.)

All legal costs are paid by the department and the department must identify or seek funding for these costs or consult with CTR relative to funding from the Settlement and Judgment Reserve (1599-3384). Administrative claims that are appealed or transferred to a state or federal court must be referred to the Office of the Attorney General (AGO) for representation by the AGO or an approved Special Assistant Attorney General (SAAG). Representation costs or damages awarded against employees defended in administrative actions (other than orders for personal damages) are not tax reportable as income to the employee. Resulting awards of damages to claimants are tax reportable based upon the damages awarded, as discussed in this policy.

Note that it is CTR's position that the Commonwealth may not, either through the Settlement and Judgment Reserve or through a department's operating account, reimburse attorneys' fees for public employees appearing before the Board of Bar Overseers or the State Ethics Commission. See *Triplett v. Town of Oxford*, 439 Mass. 720 (2003).

Civil Litigation Against the Department as the Defendant

In many cases, when civil litigation is brought against a department, the AGO provides legal representation to defend the department. When the AGO determines that it cannot provide legal representation for the department due to a conflict, the department has two choices for obtaining legal counsel:

1. Procure outside legal counsel to represent the department. Executive departments seeking representation by outside counsel must comply with M.G.L. c. 30, § 65, 801 CMR 21.00, and Object Code H09 or N03 in the CTR Expenditure Classification Handbook. Selected counsel must be appointed by the AGO as a SAAG in order to represent the Commonwealth; or
2. Have the department's legal counsel appointed by the AGO as a SAAG, if counsel is sufficiently experienced in the type of civil litigation at issue and the SAAG designation is approved by the department head.

Civil Litigation Against Specifically Named Employees (Sued in Official Capacity)

When civil litigation is brought against a specifically named employee (current or former) in the employee's official capacity, the AGO provides legal representation to defend the employee. When multiple employees are named, or when an employee is sued in their personal capacity (acting within the scope of employment), or there is another conflict, the AGO determines whether it can provide legal representation for the employee(s). For claims against a specifically named employee of the department (current or former) for which the AGO determines it cannot provide legal representation due to a conflict, the department has two choices:

1. Procure outside legal counsel to represent the employee. Executive departments seeking representation by outside counsel must comply with M.G.L. c. 30, § 65, 801 CMR 21.00, and Object Code H09 or N03 in the Expenditure Classification Handbook. Selected counsel must be appointed as a SAAG if employee is sued in their official capacity. In cases in which the department is also a defendant, or when a conflict of interest may be present, the department should not procure outside counsel directly but instead require the employee to procure their own outside counsel.
2. An employee sued in their personal capacity may procure their own outside counsel. The department would sign an indemnification agreement with the employee and outside counsel outlining the conditions for reimbursement of legal expenses and other costs, including damages, if appropriate and subject to approval by the department and, if an Executive department, approval by the Executive Office for Administration and Finance ("A&F"). The department may also require certain minimum qualifications for the attorney (to ensure that the counsel is qualified to provide the type of legal services required) and limit the rate that the department is willing to indemnify to contain legal costs for the Commonwealth. The Commonwealth is not required to indemnify unreasonably high or inflated litigation costs. All fees and costs must be documented and reviewed by the department prior to payment, subject to privilege protections for such documents.
    (a) For executive departments, all indemnification agreements must be approved by A&F Legal prior to incurring any legal costs.

(b) Indemnification agreements may not include retainers or advanced funding.

Employees sued in their individual capacity are entitled to legal representation and indemnification for any awarded damages, subject to certain conditions. Employee indemnification expenses include legal fees, costs and damages (not to exceed $1 million) arising out of a claim, action, award, compromise, settlement or judgment by reason of an intentional tort, or by reason of any act or omission which constitutes a violation of the civil rights of any person under any federal or state law; subject to the criteria that the employee or official at the time of such intentional tort, act, or omission:

1. Was acting within the scope of his official duties or employment; and
2. For employees who are not constitutional officers, the employee was not found to have acted in a "grossly negligent, willful or malicious manner" or, for police officers, did not act in a "willful, wanton, or malicious manner."

Indemnification will not be authorized at the conclusion of litigation if the employee is found to have failed one or both conditions. If the employee has failed one or both conditions, the employee will be required to pay back all fees that the Commonwealth has paid for legal representation costs during litigation.

Civil Litigation Legal Fees and Costs

The Settlement and Judgment Reserve may be used to pay attorneys' fees to outside counsel representing a state department, or a state official or employee who is sued in court in their personal capacity for actions undertaken in that individual's scope of employment.

Depending upon the circumstances, the legal costs associated with the department's defense of a claim may be paid directly to the attorney or firm providing representation using department funds, or may be submitted to CTR for payment from the Settlement and Judgment Reserve account. Indemnification payments from the Settlement and Judgment Reserve account for employee defense expenses will not be made unless the department certifies that the requirements for employee indemnification listed above have been satisfied. Indemnification payment for legal costs may be made during the course of litigation, but only if the department and employee certify in writing that:

- To the best of the department and employee's knowledge and belief, the two criteria for employee indemnification have been met;
- Requiring the employee to pay for litigation expenses up front would present an unreasonable financial burden for the employee, and the employee is not able to obtain adequate legal representation without such funding; and
- If, at the conclusion of litigation, either of the employee indemnification criteria is not met, the department will seek to recoup the funds from the employee, and the employee agrees to automatic intercept or garnishment of funds from any Commonwealth funds payable to the employee.

An employee's legal representation costs are not considered operating expenses. Payment for employee legal representation is subject to CTR approval and may be eligible for payment from the Settlement and Judgment Reserve. Departments choosing to pay for legal costs using department funds may not later seek reimbursement from the Settlement and Judgment Reserve account.

Attorneys receiving payments will receive a Form 1099-MISC (Box 10) for the amount of payment. Reimbursements to employees or payments made on behalf of employees for legal representation are not tax reportable, provided the Commonwealth is reimbursing the employee for substantiated expenses or making payments to an attorney at the conclusion of litigation. See M.G.L. c. 258, §§ 9-9A.

All costs associated with legal representation by the AGO (expert witness, depositions, court reporters, etc.) are paid by the department to the AGO through an Interdepartmental Service Agreement (ISA) executed in accordance with CTR's ISA policy. ISAs must be in place with funding reserved prior to any obligations being incurred. For litigation that crosses fiscal years, departments should work with A&F and CTR to ensure that sufficient funds are available for litigation costs. Contracts for legal services may not include payment of a "retainer" in advance of services being performed. Contracts must encumber sufficient funds to support the anticipated costs of litigation but may not advance funds to an attorney prior to the provision of services and may not include language that a retainer is due as a first payment once services have begun. Payments may be made within the first week of service, subject to Prompt Payment Discounts for accelerated payments in less than the standard 45-day payment cycle. For more information, see the CTR Bill Payments Policy.

Claim Process

CTR Review of Settlement and Judgmnet Payment Instructions

All monetary settlements or judgments, irrespective of whether the department plans to pay the claim with department funds or through the Settlement and Judgment Reserve, must be reviewed by the CTR Settlements and Judgments Team prior to the issuance of a payment. This is to ensure that payments are made using the appropriate codes and that proper tax withholding and reporting is made.

A monetary settlement or judgment includes any action which results in a payment being made to, or on behalf of, a claimant; "creditable" service for retirement calculation purposes for a state employee; existing retirement benefits; or may result in a future commitment of funds, services, or state resources outside of the normal course of business.

- A settlement or judgment on an employee grievance which makes an adjustment to vacation or sick time or other leave (which does not have any associated payments, reimbursements or changes in creditable service) will be considered a "non-monetary" settlement or judgment which does not have to be reviewed by CTR prior to the payroll adjustment.
- A settlement or judgment on an employee grievance which reinstates, promotes (with back pay), or makes an employee whole for a number of days is a "monetary settlement or judgment" and must be reviewed by CTR. CTR will provide the payroll earnings code for accurate tax reporting.
- A settlement or judgment awarding attorneys' fees or payment to a third party (even if no payments are being made directly to a claimant) is considered a monetary settlement or judgment, because the award is being paid on the claimant's behalf, thus it must be reviewed by CTR for the proper processing instructions.
- A settlement or judgment that includes a consent decree or court monitor assignment which will result in an ongoing commitment of funds, services, or other mandate for Commonwealth participation will be considered a "monetary" claim and must be reviewed by the CTR Settlements and Judgments Team for the proper processing instructions. In addition, these

settlements or judgments may not be negotiated or finalized without participation from A&F. Funding in such instances is subject to the appropriation process. Please see "Special Appropriations" in "Funding Sources for Settlements and Judgments," below, for additional information.

Communication with Claimant or Claimant's Attorney

Department counsel should not refer a claimant or claimant's attorney to CTR for questions related to a settlement or judgment. CTR has no authority to make representations on behalf of any department, and will refer all questions related to a claim back to the department counsel for resolution. CTR will work with the department counsel or, if not represented by an attorney, with the department Chief Fiscal Officer (CFO) to resolve questions related to the payment or processing of a settlement or judgment**.**

CTR will not communicate directly with a claimant, claimant's attorney, union representative, or any other individual related to a claim. When questions on tax reporting or withholding arise, a copy of this document or other related references may be provided to a claimant, claimant's attorney, union representative, arbitrator, or court.

Department Counsel and Department Responsibilities

Department counsel, CFOs, and Payroll Directors are responsible for ensuring that claims against the Commonwealth are negotiated and processed in compliance with 815 CMR 5.00 and this policy.

a. The department must complete the Non-Tort Settlement and Judgment Authorization Form in its entirety. The department counsel and CFO are the central point of contact for CTR for questions about the claim.

b. The department counsel is responsible for ensuring that the claimant or claimant's attorney have been provided with the "Notice of Settlement/Judgment Tax Reporting And Withholdings, claimant Receipt of W-2, 1099-MISC or 1099-INT Forms," which includes notice that payments, once issued by the Commonwealth, may be reduced due to intercept for any outstanding Commonwealth debts (including state or federal taxes, child support, or student loans). No claim for non-payment or reduced payment may be brought against the Commonwealth for tax withholdings or intercept.

c. In employment related claims, the department counsel is responsible for working with the department CFO and HR/payroll staff to process a settlement or judgment payment once approved by CTR. The department counsel must ensure that the department HR/Payroll employee listed on the authorization form is provided with a copy of all paperwork that is submitted to CTR for employment-related back pay, lump sum, and other payments that will be processed through HR/CMS.

d. Since certain claims may be subject to significant interest for late payment, the department counsel is responsible for ensuring that claims are submitted to CTR with complete documentation and information in a timely fashion, but not later than two (2) weeks after the date that department counsel receives the executed settlement/judgment documents, releases, Forms W-9 or tax information.

e. The department counsel must track any paperwork submitted to the department for signature (e.g., Non-Tort Settlement/Judgment Payment Authorization Form) and ensure that the signature process is expedited to ensure timely filing of claims for payment.

f. The department counsel must verify that all tax identification information submitted by a claimant or other payee has been obtained, as required in this policy.

g. A stipulation of dismissal for litigated claims must be executed by the parties for a litigated settlement payment to be made, however department Counsel or Claimant's attorney may choose to delay filing that stipulation with the relevant court until they receive proof of payment.

h. If the department counsel is an Assistant Attorney General ("AAG") or SAAG, they must work with the represented department's legal and fiscal staff to ensure that complete paperwork is submitted to CTR for processing.

i. The department counsel is responsible for all communications with claimant and claimant's attorney.

j. The department counsel is responsible for ensuring that the department maintains the originals/record copy of all documents related to a claim for the applicable record retention period. Copies of claims submitted to CTR for administrative processing purposes also will be retained for the applicable records retention period.

Claim Negotiation Limitations

Departments are responsible for negotiating or litigating claims in the most cost-effective manner for the Commonwealth. Please note the following limitations regarding what can and cannot be supported when CTR processes a claim:

1. Taxability, tax reporting, or withholdings as part of a claim

CTR does not determine whether a claim is taxable (i.e. whether an individual will ultimately be required to pay taxes), only whether the claim is tax reportable and if tax withholding by the Commonwealth is required. CTR will process claims in accordance with applicable state and federal tax laws and policies as outlined in this policy.

With very limited exceptions, all employment settlements and judgments for current or former state employees are tax reportable and must be processed through the HR/CMS system to ensure that the appropriate tax, retirement, and payroll deductions, withholdings, and tax reporting are made. Pursuant to I.R.C. § 3402(a)(1), the Commonwealth is required to withhold income and employment taxes on employee wages (for both current and former employees) awarded in settlements and judgments, even if payment of the settlement or judgment is to be made payable jointly to the claimant and claimant's attorney. See Tax Implications of Settlements and Judgments.

2. Timing of Payments

The timing of payment for claims paid from the Settlement and Judgment Reserve or any other fund is not negotiable. Payments are processed based on: (1) when the claim is submitted to CTR with all supporting paperwork completed; and (2) availability of the funds designated for payment of the claim. Although payment for properly filed claims is guaranteed (subject to any specific legislative restrictions), all payments are subject to appropriation and the exact timing of payments cannot be guaranteed.

3. Retirement Contributions and Retirement Creditable Service

The State Retirement Board has approved automated retirement contributions only for back pay employment awards which are processed through HR/CMS. Retirement contributions and

modifications to creditable service can only be made when "salary" has actually been "earned" for time worked or time that would have been worked if the employee had not been suspended, terminated, subject to layoff, etc. An employee cannot be awarded back pay amounts that exceed the number of days between the separation in service and the award, or the number of hours being compensated for back pay (i.e. the employee cannot be paid more in back pay or earn more creditable service that the employee would have earned if employed during the time in dispute). Therefore, any settlement amount for contributions or creditable service which is not part of a back pay award must be negotiated separately with the State Retirement Board and approved in writing prior to a final settlement or judgment. In most cases, these adjustments and payments will not be processed through CTR, but will be made directly by a claimant to the State Retirement Board. See Back Pay Retirement Contributions.

4. Front Pay

Front pay is a damages payment to an employee to compensate the individual for remuneration that would have been received after the settlement date or court award but for the employer's alleged wrongful conduct or, in a situation of extreme animosity between the employer and employee, which make it impracticable to return the employee to the position. Front pay is considered by the IRS to be "wages" and not "back pay," therefore these amounts are not subject to retirement contributions and cannot be used for creditable service. Front pay is considered wages subject to employment taxes in the year paid and is subject to the tax rates and Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) wage bases in effect during the year paid.

5. Deferred Compensation Contributions

Deferred compensation contributions may be made by employees from the Settlement and Judgment Reserve as a direct payment to the deferred compensation vendor (a contracted vendor through the Office of the State Treasurer (TRE)) and not through the payroll system as a payroll deduction.

6. Pulled Checks

Payroll payments are entered into HR/CMS and then processed through the Commonwealth's enterprise financial accounting and reporting system. Checks or electronic payments (EFTs) are issued through TRE as manager of the Commonwealth's bank accounts. Departments may not negotiate or agree as part of a settlement or judgment that a check will be "pulled" rather than mailed through the normal process unless there are extenuating circumstances. CTR will request pulls from TRE in such circumstances. Absent such a request, payees (including attorneys) who are set up in the Commonwealth's enterprise financial accounting and reporting system and current employees paid through HR/CMS using EFT-direct deposit will be paid through EFT-direct deposit.

7. Current Employee Payments to Attorney or Third Party

Back pay or lump sum payments for a *current employee* must be processed through HR/CMS, and cannot be made payable jointly to an attorney or other third-party payee. The Commonwealth is not responsible for ensuring that claimants honor or pay fee agreements with attorneys or any other third party.

8. Separate Cover Documents – Allocation of Payment Terms

CTR will not accept cover sheets, letters, emails or faxes requesting a breakdown or allocation of damages or payment processing requirements. Payments are processed in accordance with the terms of the settlement or judgment document, not by separate agreement, letter, or memorandum between the parties.

9. Intercept and Wage Garnishments

All settlement and judgment payments are subject to intercept for outstanding debts (tax liabilities, child support, student loans, etc.) and no claim for failure to pay may be made against the department or the Commonwealth for honoring intercept claims. Claims are only intercepted after a claimant has received notice and an opportunity to dispute the debt or receive a hearing under 815 CMR 9.00. Employment claims processed through HR/CMS are subject to existing wage garnishments in HR/CMS (child support, tax liens, student loans, etc.)

10. Public Records Disclosure by the Office of the Comptroller

Provisions that require settlement terms be kept confidential may not be enforceable unless the claim or certain provisions in the claim are exempt from disclosure under the Massachusetts Public Records Law. Based upon a 2013 court decision, Globe Newspaper Co., Inc. v. Executive Office of Administration and Finance, et. al., Suffolk Superior Court Civil Action No. 11-01184-A, the name of a recipient payee of a settlement or judgment payment made from the Settlement and Judgment Reserve is considered a public record. CTR is required to release the department name, amount of a payment, and the name of the payee recipient, unless the department has identified a specific statutory exemption for the payee recipient as part of its submission of the claim for payment. In the absence of a court order, CTR will not produce tax forms (Form W-4, Form W-9, Form 1099) associated with a claim without a claimant's written consent, as these are considered highly personal and confidential.

11. Class Action Special Considerations

It is not uncommon for large class actions to hire a Claims Administrator and Class Counsel (collectively, Claims Administrator) to handle the litigation. In private litigation, parties often negotiate terms that the Commonwealth cannot support, such as setting up escrow accounts to hold settlement funds until the settlement is completed, or funding attorneys' fees prior to the finalization of a settlement. Negotiated terms cannot override this policy or any state or federal law or regulation.

CTR has the sole discretion to determine, based upon the amounts payable to individual class members, whether payments will be entered into the Commonwealth's enterprise financial accounting and reporting system by individual class member, or whether a lump sum payment will be issued to the Claims Administrator for disbursement. This decision will be made based upon the class of individuals to be paid, the likelihood that payments issued through the Commonwealth's enterprise financial accounting and reporting system will actually reach recipients, whether the amounts support the ability to collect intercept of debts, intercept fees, and the most cost-effective use of taxpayer funds to fulfill the terms of a judgment or settlement and any associated tax liabilities. CTR may screen class member Tax Identification Numbers (TINs) for potential intercepts and may identify a subset of class members whose payments will be processed by CTR to enable intercept, with the remainder of class members paid through disbursements made by the Claims Administrator.

Other class action considerations include:

a. All named class members who receive monetary awards for damages will be required to provide proof of legal name, legal address and TIN or federal employer identification number (FEIN) through submission of an IRS Form W-9 to the Claims Administrator or to CTR, if none.

b. If the payments are made through the Commonwealth's enterprise financial accounting and reporting system to individual class members, the class members will receive a system-generated Form 1099-MISC.

c. If CTR determines that a lump sum payment will be issued to the Claims Administrator for disbursement to class members, the Claims Administrator will be responsible for any tax reporting to class members in accordance with tax laws.

d. CTR has no obligation to inform the Claims Administrator when there are sufficient funds for payment and has no authority to accommodate specific time periods for payment or other demands in conflict with this policy. Class action payments are treated the same as any other settlement or judgment payment and will not be paid ahead of any other claim already in line for payment.

e. Class action settlements should contain language stating that the Commonwealth is released from any residual or remaining amounts that are not paid out under a settlement. If class members cannot be identified, or if the full amount of the award cannot be disbursed, remaining funds may not be paid to the Claims Administrator for administrative costs or used for other purposes. There should be no windfall of taxpayer funds used for other purposes unless so ordered by a court. If the holder of the residual funds is a government or governmental subdivision or agency of the Commonwealth, then any residual funds must be paid to the state's Unclaimed Property fund. If the funds were paid to a Claims Administrator who then was unable to distribute them to all class members, the residual may be directed to the IOLTA fund, pursuant to MRCP 23(e)(3), or some other beneficial fund, depending on the language of the settlement or judgment.

f. The accuracy of claim forms is critical, and claimants must be informed that any discrepancies in the claim form from what the IRS or DOR has on file for tax reporting information may result in an unnecessary delay in payment or misrouting of the payment. If individual class member payments are being processed by CTR, the Commonwealth will be released of any responsibility for mistakes in payment information once the Claims Administrator certifies the payment information for class members, including deceased class member representatives. Once a payment is issued by the Commonwealth, it may not be re-issued with a different name, address, or tax information unless the initial payment has been canceled.

g. If CTR has issued payment and funds have been intercepted for outstanding debts (for taxes, child support etc.), the claimant will get notice on the check stub with a contact for the department that intercepted the amount. Intercepts are not made unless the claimant has been afforded due process prior to the claim being processed, thus claimants cannot

challenge an intercept through CTR and must instead contact the department that issued the intercept. For child support payments, intercepts are statutorily mandated from any payments made to a claimant.

h. Any checks returned to the Commonwealth will be forwarded to CTR, which notifies the Claims Administrator of the returned check. It is the responsibility of the Claims Administrator to locate the affected class members. CTR will not assume any responsibility for attempting to locate class members for un-cashed or undeliverable checks.

i. Deceased Class Members. Representatives for a deceased class member may file a claim form on behalf of the class member's estate or may return an un-cashed check to the Claims Administrator if the class member died before cashing the check. The representative must provide the Claims Administrator with documentation that an estate has been established in accordance with the law and that the representative is the duly appointed administrator or executor, including a Form W-9. The Claims Administrator must verify that the representative is an eligible and legally authorized recipient of the funds. In the event there is a dispute or challenge to the representative's receipt of the funds, the Claims Administrator will be solely responsible for resolving this issue.
If a participating class member dies after the Claims Administrator has certified payment information but before taking possession of the payment, the Claims Administrator will be responsible for working with CTR to re-issue the check to the appropriate representative.

Funding Sources for Settlements and Judgments

Claims may be paid only with legally available funds, which include funds appropriated specifically for the payment of settlements and judgments or authorized for the payment of certain contractual expenditures, and do not include any funds not specifically authorized by 815 CMR 5.00 for use in the payment of judgments and settlements, including any legislatively authorized "special funds" and trust funds as defined in G.L. c. 29, § 1. Special funds and trust funds must be used solely to further statutorily authorized goals, which should not be interpreted to include the payment of settlements and judgments unless these types of payments are specifically mentioned in the enabling act.

Budgetary operating funds, federal grants, trust funds, capital funds and other types of funds are not appropriate sources of payment for settlements and judgments in the absence of specific authorizing language and should not be used to make claim payments. Even if claim payments are court-ordered or a settlement states they are to be paid immediately by a department, contrary to policy, these payments are made "subject to appropriation," similar to all other payments by the Commonwealth.

Departments that choose to use department funds may not later seek reimbursement from the Settlement and Judgment Reserve. See the CTR Expenditure Correction (EX) Policy. If a department plans to pay a claim with department funds, the legislative appropriation must be identified in the claim form submitted to CTR.

When determining the source of funding for payment of a particular claim, departments should consider the following:

1. M.G.L. c. 258 Torts

All M.G.L. c. 258 tort claims and associated legal costs are paid through the Liability Management and Reduction Fund. Please refer to the CTR Liability Management and Reduction Fund – Tort Claim Policy for additional information.

2. Settlement and Judgment Reserve (1599-3384)

The Settlement and Judgment Reserve is the default account for all non-tort settlement and judgment claims when a department does not have sufficient legally available funds. Non-tort claims paid through the Settlement and Judgment Reserve account are not currently charged back to departments.

The Settlement and Judgment Reserve account is funded by the Legislature through the General Appropriations Act (GAA) and may receive supplemental appropriations throughout the fiscal year based upon the volume of claim obligations. The timing of the Legislature's enactment of any GAA appropriation or supplemental appropriation is uncertain, therefore the timing of payment cannot be guaranteed or negotiated as part of a settlement or judgment. The availability of funds depends upon the volume and size of claims submitted at any given time during the fiscal year. CTR has no control over when appropriated funds will be available for payment.

3. Non-Tort Employment (Former Employees)

Employment-related claims that result in payments to a former employee who was terminated, died, retired, or resigned during a prior fiscal year should be paid from the Settlement and Judgment Reserve account rather than from current department payroll appropriations, which are not legally authorized for these types of claims. Higher education university or community colleges may use non-appropriated local trust funds if the trust language is broad enough to cover this type of expenditure.

4. Eminent Domain

Eminent domain payments are made from capital or other appropriations authorized for the related land acquisition and are not paid by CTR. Claims submitted to CTR will be forwarded to the general counsel for the department subject to the eminent domain claim.

5. Department Funds

Departments seeking to use department funds to pay a claim must obtain prior written approval from CTR for use of these funds and follow the standard CTR review process for settlements and judgments to obtain payment instructions.

a. Non-Tort Contract Claims

Contract claims should be paid from the department appropriation that is currently funding, or available to fund, the contract in dispute. Payment of claims involving a terminated contract when the funding appropriation has also terminated will be determined by CTR as either a prior year deficiency (PYD), which will be charged back to a current department contract appropriation (usually done for settlements of a contract claim) or the Settlement and Judgment Reserve account (usually done only for judgments or administrative rulings against the Commonwealth relative to a contract claim with an expired payment account). Contract claims require prior review and approval of payment instructions by CTR.

b. Non-Tort Employment (Current Employees)

Employment-related claims for current (active) employees, or former employees who were last paid by the department on the current fiscal year's payroll (i.e., they were terminated, resigned, died, or retired during the current fiscal year), may be paid from current department appropriations ONLY when the following conditions are met:

i) The payment is for back pay or reimbursement damages (all other non-payroll costs, such as lump sum, front pay, emotional distress, attorneys fees, legal costs, punitive damages and interest, may not be paid with current payroll funds but must be paid by special appropriation or the Settlement and Judgment Reserve). The one exception to lump sum payments is for overtime that was not paid by the department which may be paid using current fiscal year payroll funds upon approval by CTR. Other "compensatory" damages for emotional distress, unspecified damages, or damages to settle a case may not be paid from current payroll funds.

ii) The department determines that payment of the claim from payroll funds is a necessary and appropriate business payroll expenditure.

iii) The payment does not create any risk of the department running into a payroll deficiency at any time in the fiscal year (Executive departments must confirm with A&F).

iv) The payment will not significantly impair payroll related funding necessary to conduct department business.

v) CTR has reviewed and approved the payment.

c. Non-Tort Civil Rights or Other Non-Employment Claims

Non-employment-related claims may be paid from current department appropriations or other available funds only when the following conditions are met:

i) The appropriation or fund language is broad enough that it can be interpreted to legally cover this type of expenditure.

ii) The department determines that payment of the claim from available funds is a necessary and appropriate business expenditure.

iii) The payment does not create any risk of the department running into a funding deficiency at any time in the fiscal year (Executive departments must confirm with A&F).

iv) The payment will not significantly impair funding necessary to conduct department business.

v) CTR has reviewed and approved the payment.

6. Special Appropriations

Exceptionally large claims or claims with extenuating circumstances may necessitate a separate, special appropriation by the Legislature. Departments in the midst of litigation or settlement negotiations regarding a claim anticipated to exceed $1,000,000 should consult with CTR and A&F to determine

whether the claim should be submitted for payment from the Settlement and Judgment Reserve, or whether a bill authorizing a separate special appropriation should be filed.

CTR and A&F review is also required for any consent decree, settlement, or judgment that may require an ongoing commitment of funds, resources, or services by the Commonwealth unless otherwise mandated by law. Such funding is subject to appropriation and must be supported through the normal budgeting process. No state official or attorney has the authority to legally bind the Commonwealth to a future fiscal obligation without approval of the Legislature through the appropriation process. Departments should notify CTR and A&F immediately of any such consent decree, settlement, or judgment that may be finalized in the current or next fiscal year, and no such claim may be finalized without a plan for funding approved through A&F or the appropriate budget authority.

As the result of certain settlements or judgments, a department may be required to fund ongoing periodic payments for consent decrees, medical costs, legal costs or court monitor review or other costs as part of the claim resolution. These cases may mandate a service or other activity that may or may not have a related payment. In these cases, the ongoing costs are considered a departmental operational cost and the department must maintain sufficient appropriations to cover these ongoing compliance costs. These mandated payments may not be submitted for payment from the Settlement and Judgment Reserve if the department fails to obtain the necessary funding, or the department undergoes M.G.L. c. 29, § 9C allotment reductions. The department will instead be responsible for taking the necessary steps to adjust internal expenditures or initiate the deficiency process under M.G.L. c. 29, § 9E.

Types of Damages

For the purposes of tax reporting and withholding, the Commonwealth classifies damages in the following categories:

1. Back pay or salary replacement (current or former employees only).
2. Lump sum or non-specified damages (emotional distress, overtime, front pay, compensatory, consequential, treble, civil rights, or other all-inclusive or non-specified damages to resolve a claim).
3. Attorneys' fees and costs (awarded or negotiated).
4. Interest on damages or on attorneys' fees (G.L. c. 231, § 6I or other statutory fee).
5. Punitive damages:

   Punitive damages must be specifically identified as "punitive damages" or other comparable term in the settlement or judgment. Punitive damages do not require tax withholdings and will be reported to the claimant on a Form 1099-MISC (Box 3). See 1099-MISC Instructions Box 3 Other Income at: https://www.irs.gov/pub/irs-pdf/i1099mec.pdf

   Punitive damages paid to a former employee may be paid solely to the claimant or jointly to claimant's attorney or a third party and can be processed through HR/CMS or the Commonwealth's enterprise financial accounting and reporting system as considered appropriate by CTR. For

punitive damages paid solely to a claimant former employee, payment through HR/CMS is preferred. Payments of punitive damages payable jointly to an attorney or third party will usually be entered under the TIN/EIN of the attorney or third party.

6. Non-tax-reportable damages:

    a. G.L. c. 258 tort personal injury or property damage (subject to IRS definitions).

    b. Reimbursement for substantiated actual medical expenses for emotional distress.

    c. Reimbursements (subject to IRS definitions). Reimbursement types are limited.

    d. Indemnification (reimbursement for defense costs or attorney payments authorized under G.L. c. 258).

    e. Wrongful or erroneous convictions. (compensation for certain erroneous felony convictions under G.L. c. 258D).

Processing Steps for Settlements and Judgments and Approval of Payment Instructions

CTR review is required prior to payment of all claims, even if a department plans to make payment from departmental funds. This ensures that payment is made consistent with state and federal tax reporting and withholding requirements, the terms of the claim documentation, and state finance law requirements.

Certified True Attest Copies (not originals) of settlements and judgments and M.G.L. c. 258 tort claims are submitted to CTR along with the Settlement and Judgment Authorization Form and supporting documentation to support payment. The department or department counsel is responsible for submitting proper documentation, as outlined in the Form instructions. Claim documents should be submitted to the CTR Settlements and Judgments Team through DocuSign or Adobe Acrobat Sign.

The department is responsible for retaining the original copies of all settlements or judgments for records retention purposes. Departments should not include internal memoranda discussing the claim or other internal department or attorney/client documents that are not part of the claim. These documents should be retained in the department's internal files.

Claims should not be submitted to CTR and put in line for payment until the claim is final, with no further appeals or reviews. CTR cannot approve partial payments pending conclusion of final disposition of a claim.

Claims are put "in line for payment" once all documentation has been received "complete," reviewed by CTR, and the claim payment instructions have been finalized. If any paperwork is missing or is submitted at a later date, the claim cannot be reviewed and will be taken out of the queue until complete documentation is received. Different types of claims have differing timelines for payment:

- **Settlements**
  Settlements cannot be put in line for payment until the claimant has signed a release of all future claims related to the same issue, which may be included as part of the settlement agreement. Note that any separate release document must identify the total amount to be

paid under the settlement, including amounts paid on behalf of the claimant to the claimant's attorney or another third party.

- **Consent decrees**
  A claim will not be put in line for payment until all documents triggering the payment obligation have been executed by the parties.

- **Class Actions**
  For class actions involving multiple claimants receiving payment, a claim will not be put in line for payment until all documents triggering the payment obligation have been executed and all claimant releases have been obtained and are verified by the Claims Administrator as accurate and complete.

- **Litigated Cases**
  A Stipulation of Dismissal must be executed by all parties.

Any re-hiring updates for former employees being paid must be finalized no later than the Friday prior to the scheduled payroll payment date. Payroll payments must be entered by the department using CTR-provided instructions no later than the Monday preceding the scheduled payroll payment date. Payroll portions of claims are processed according to the bi-weekly payroll cycle, which may result in delays in payment if claims are submitted too late in the pay period. In such cases, payment may be delayed until the next pay period. CTR Payroll will direct the payroll charges to the Settlement and Judgment Reserve account or other appropriate account.

Payroll claim payments for former employees who have since been rehired by another department will be treated as a payment for a current employee, and CTR will work with both the Claimant department and the current employer department to enter payment and enter the rules to direct the payroll charges to the Settlement and Judgment Reserve account or other appropriate account.

Failure to submit required documentation or failure to correctly complete the Non-Tort Settlement/Judgment Payment Authorization Form will delay a claim from being placed in line for payment. Claims cannot be put in line for payment if a claimant or claimant's attorney refuses to sign a settlement agreement, release or stipulation of dismissal (although the department counsel can agree to delay filing the stipulation until the claim is confirmed as paid). Without exception, CTR is unable to process claims without completed information and certified/attested copies of the required documentation.

CTR will identify the approximate number of claims in line ahead of any claim, upon request by the department counsel, department, AAG or SAAG assigned to the claim. CTR will not communicate approximate payment dates to claimants, claimant counsel, or any other interested party.

Payments are made based upon the "in line for payment" order, subject to the availability of funds. If sufficient funds are available to make payment, CTR will take the necessary steps to make payments through the Commonwealth's enterprise financial accounting and reporting system (non-payroll portions of claims) and issue instructions for departments to enter payroll-related portions of claims through HR/CMS for bi-weekly payroll payments.

CTR will process claims in line for payment as expeditiously as possible given staff resources. If payment is issued after a specified payment date in a settlement or judgment, and late payment interest is required, CTR will issue this interest as an additional payment along with the claim.

Payment Options and Authorized Payees for Settlements and Judgments

Payments will be issued to payees listed in the settlement and judgment documents. If the settlement or judgment is silent on the payee name, payment will be issued to the named claimant. If multiple claimants are named in a settlement or judgment, each with specified amounts, separate payments will be issued to each claimant for the specified amount. If multiple claimants are named and specified amounts are not listed for each claimant in the settlement or judgment, separate payments will not be issued without signed releases from each claimant identifying the amount of their portion of the claim.

Income, net proceeds, or fee assignment agreements between a claimant and attorney or a third party are not binding upon the Commonwealth and will not be honored for purposes of making payment solely to an attorney or third party or changing the Commonwealth's tax withholding or reporting responsibilities related to the claimant. Authorized third party payees include claimant insurers, administrators of an estate for the claimant, or other payees authorized in the settlement or judgment.

Payments will not be issued solely or jointly to an attorney or other third party unless they are identified as an authorized payee in the settlement or judgment, or the claimant has signed a release identifying that payment may be issued jointly or solely to that payee.

The following are some of the payment options routinely requested or indicated in an award:

a. **Payable to claimant, mailed to claimant address (or direct deposit)**

   Payments to current employees will be processed along with regular bi-weekly salary payments. Former employees and non-employee payees will receive a check, unless EFT is still active in the payroll or accounting system. This option may not be used for amounts representing attorney fees and costs, which must be paid directly to claimant's attorney.

b. **Payable to claimant, mailed to attorney or third party address**

   This option may not be used for current employees receiving back pay or lump sum damages, since withholding is required prior to payment. The payroll system cannot currently segregate regular salary from other types of payments. Therefore, these net amounts will be paid directly to claimant along with regular salary. Payments to former employees (not currently employed by any department on the payroll system) and to non-employees can be issued under this payment option. Payments issued under this option are delivered to the attorney or third party. Tax reporting is not triggered for the attorney or third party, since they are not listed as a payee on the check.

c. **Jointly payable to claimant and attorney or third party and mailed to attorney or third party address**

   This option may not be used for current employees receiving back pay or lump sum damages, since withholding is required prior to payment. The payroll system cannot currently segregate regular salary from other types of payments. Therefore, these net amounts will be paid directly to claimant along with regular salary. Payments to former employees (not currently employed by any department on the payroll system) and to non-employees can be issued under this payment option.

d. Payable solely to attorney or third party and mailed to attorney's address.

This option is used primarily for attorneys' fees and payments directed to a third party. Payments to ***former*** employees (not currently employed by any other department on the payroll system) and to ***non-employees*** can be issued under this payment option provided the settlement or judgment document identifies the payment as solely to attorney or third party or a separate release has been signed by the claimant requesting payment directly to the attorney or third party. Payments made under this option to an attorney or third party will trigger tax reporting for the amount of the payment, in addition to any tax reporting for the claimant. This option will not shift any tax reporting or tax liabilities from the claimant. The Commonwealth reserves the right to report any amounts issued to an attorney or third party to the claimant.

Electronic Fund Transfer (EFT/Direct Deposit)

CTR will try to accommodate payment method requests within the parameters identified in this policy. When settlement or judgment documentation does not specify a particular payment method, counsel representing the department should obtain documentation for EFT payment. Payments will default to EFT/direct deposit (rather than a physical check) if the payee is already set up for EFT on the state payroll or accounting systems. Payroll claims for back pay and lump sum damages for current employees must be processed along with regular wages and cannot be split out into a separate check or made payable jointly to an attorney or third party payee.

Payees who anticipate receiving routine or multiple payments of at least four payments per year, including law firms representing plaintiffs, must set up EFT. See the CTR Vendor / Customer File and Form W-9 Policy.

VendorWeb and Vendor Lookup for Details of Payments

VendorWeb (Internet)

Claimants and attorneys can verify remittance details for payments through the Commonwealth's enterprise financial accounting and reporting system through VendorWeb using the Vendor Code and the last four digits of the TIN associated with that Vendor Code. Vendor Codes can be provided to payees by the department responsible for the claim.

Vendor Lookup (Intranet)

Department counsel can look up payments through the Commonwealth's enterprise financial accounting and reporting system using Intranet Vendor Lookup using the Payee name or Vendor Code. See: Electronic Funds Transfer Policy in the CTR Bill Payments Policy.

Tax Reporting Considerations

To ensure that the Commonwealth meets its tax reporting and withholding obligations and to protect claimants, it is CTR's policy to adopt the most conservative approach with respect to tax reporting and withholding responsibilities as identified by the IRS or DOR. When there is ambiguity as to tax withholding or tax reporting responsibilities, or there are risks of potential tax withholding penalties for either the Commonwealth or claimants, CTR generally will default in favor of withholding and tax reporting.

CTR makes no representations as to the tax consequences of a payment, and claimants and claimant attorneys are responsible for all tax liability and tax consequences of a payment. The Commonwealth will be held harmless as to any tax liability of the claimant. CTR provides guidance solely on how it will process settlements and judgments and the withholdings and tax reporting forms.

Wages Subject to Withholdings Prior to Payment

For the purposes of Massachusetts state income tax reporting and withholding, G.L. c. 62B adopts the federal definition of "employer" found in I.R.C. § 3401(d), "employee" found in § 3401(c), and the definition of "wages" found in § 3401(a).[1] See M.G.L. c. 62B, § 1. See also M.G.L. c. 62B, § 7 for penalties for failure to withhold taxes.

When determining whether remuneration is for employment and therefore considered "wages," two questions must be asked:

1. Was the claimant an employee of the department at the time of the alleged wrongdoing by the department?
2. Did the settlement or judgment arise out of the claimant's current or previous employment relationship with the department?

If the answer to these questions is "Yes," then, with limited exceptions, damages awarded will be processed as "wages" and subject to tax reporting and withholding for state and federal income taxes and the Medicare portion of FICA (unless the employee is exempt).

> Note: The Commonwealth does not withhold Social Security payments from wages of employees who are members of the State Employees Retirement System ("MSERS") or retirement deductions from those participating in the Commonwealth's OBRA Plan.

The following examples regarding common situations are provided to help departments answer the questions outlined above:

> **EXAMPLE 1.**
>
> A job applicant's age discrimination claim for failure to be hired would not qualify as remuneration for employment or "wages" since the claimant was not an employee of the department, and the settlement or judgment did not arise out of a current or previous employment relationship with the department. Any resulting settlement and judgment would be a non-employment-related claim payable through the Commonwealth's enterprise financial accounting and reporting system and requiring issuance of a Form 1099-MISC (Box 3) to the claimant.
>
> **EXAMPLE 2.**
>
> A current or former employee's discrimination claim for termination, failure to promote, or failure to be hired into a different position would qualify as

[1] I.R.C. § 3401(c) defines "employee" as an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any department or instrumentality of these entities. I.R.C. § 3401(a) defines "wages" as "all remuneration for services performed by an employee for his employer."

remuneration for employment since the claimant was an employee at the time of alleged wrongdoing and the settlement or judgment arose out of the employment relationship with the department. The department must report the full amount of the award as gross income and the portion of the award not specified as attorneys' fees, costs, punitive damages or interest is considered "wages" subject to tax withholding, retirement, and other state and federal legal obligations.

Employment-Related Claims Tax Considerations

Employment claims for lump sum and back pay damages must be processed through HR/CMS and require that a former employee be rehired in the system. Please note that rehiring an employee for payment purposes creates no employment status for the former employee. This process is used to facilitate payments that must be processed through the payroll system, and to ensure accurate processing of tax withholdings and tax reporting on a Form W-2. Employment-related back pay and lump sum payroll claims are subject to tax withholdings prior to payment.

Any portion of a claim that represents "income" that is not excludable must be reported for tax purposes by the Commonwealth. For example, lump sums, back pay, wages, punitive damages, attorneys' fees, costs or interest awarded under a tort or non-tort settlement or judgment are tax reportable to the claimant. Each claimant will receive either a Form W-2 for an employee, or a Form 1099-MISC for a non-employee, for all or the portion of an award subject to tax reporting.

Pursuant to Internal Revenue Code (I.R.C.) § 61 (Gross Income Defined) and I.R.C. § 104 (Compensation for injuries or sickness), all settlements and judgments (including punitive, compensatory or liquidated damages) for "nonphysical injuries or nonphysical sickness" are tax reportable by the Commonwealth.

Claimants cannot dictate how taxes will be withheld or the amount of taxes paid, and the Commonwealth cannot by settlement or judgment agree to waive its obligation to make required tax withholdings.

Deferred Compensation and Make-Up Retirement Deductions

Payroll Directors should be instructed to turn off any additional retirement contributions, such as makeup retirement or deferred compensation for the pay period in which the award is given, since these deductions will be taken against back pay amounts if not turned off. This will result in no deductions for either make-up or deferred compensation on any regular salary or other wages paid on the pay period in which the award is given to a current employee, however, most claims do not authorize these amounts to be deducted from the claim and the Commonwealth has made a policy determination that these amounts should not be deducted. In addition, if the claim amount is significant, the deferred compensation or other deductions may result in deposits exceeding the legal limits for the employee, creating a tax violation that presents problems both for the employee and the payroll director to correct.

Back Pay Tax Withholdings

Back pay is considered "wages" and will be processed through the payroll system and subject to tax reporting and withholdings, including state and federal income tax, Medicare, and retirement deductions prior to payment to the claimant or claimant's attorney.

Back pay is automatically calculated by the payroll system as supplemental, with flat tax withholding amounts. Personal exemptions are not calculated since this would require an annualized calculation that could result in higher taxes being withheld for many claims and makes it difficult to accurately calculate the final payment amounts without processing the actual claim through HR/CMS. Withholdings are made in the following order:

1. **Retirement contributions**

   Retirement deductions are calculated at the statutory contribution rates provided by retirement plan rules for the employee based on the full amount of any back pay award constituting regular compensation, and not based on any mitigated or reduced award amount.

2. **State income tax** (back pay less retirement)

3. **Federal income tax** (back pay less retirement)

4. **Medicare tax** (back pay unless Employee is exempt)

   The department must check if the employee was subject to Medicare tax during the last payroll period paid. If exempt, uncheck the Medicare box so that Medicare is not taken (applies only if employee was hired prior to April 1, 1986, with no subsequent break in service).

5. **Existing automated wage garnishments for child support liens, tax liens, student loans, etc.**

   Department employees managing the claim should request certification of any outstanding debts owed to the Commonwealth. Outstanding child support or tax liens should be identified in addition to any wage garnishments already in place.

6. **Deductions for additional earned income/wages during separation**

   Income earned from other sources during a separation in employment for which back pay is being awarded (such as private wages, unemployment benefits, or retirement benefits) must be deducted from the final award paid so that the employee is not receiving more wages than the employee would have received had the separation from employment not occurred. Retirement benefits paid to the employee during separation must be repaid to the Retirement Board (to make the employee's account whole from any back pay award) from post-tax amounts, since otherwise the employee may be paid more retirement than the employee would have been paid if the separation from employment had not occurred.

   Unemployment benefits will be paid back to the state department of Unemployment Assistance on behalf of the employee from any back pay award, from post-tax amounts. Repayments to the State Retirement Board and the state department of Unemployment Assistance are made from post-tax back pay amounts in order to provide the full retirement credit and deductions and ensure appropriate tax withholdings. Even though the retirement payments and unemployment payments were paid with taxes deducted, the IRS does not consider the back pay award to be a reimbursement but rather considers it "a make whole" payment, which is subject to withholdings. It may appear that the employee is being taxed

twice for the same earnings, but the IRS considers the payments to be two separate income events subject to tax at the time of payment. Employees may always claim an overpayment of taxes when filing their tax returns.

Back Pay Awarded After Retirement

In the event a former employee receives a back pay award for a period of time after the employee retired and began receiving retirement benefits, the State Retirement Board requires that the final amount paid is reduced by the retirement benefits already received, from the back pay award, post-tax. For tax purposes, the IRS has determined that back pay awards, even though making the employee whole for amounts that would have been paid, are wages subject to withholding at the time of payment.

Tax Reporting and Withholdings for Employee Lump Sum Awards

Although some lump sum awards are not clearly identified as "wages," these amounts are remuneration related to employment and ultimately may be deemed by the IRS or DOR to be "wages" subject to withholdings. CTR is responsible for ensuring appropriate tax reporting to the IRS and DOR and withholding on employment damage awards. CTR does not control the manner in which awards are allocated by departments and claimants, or courts and other administrative authorities, with respect to the breakdown of payments for back pay, compensatory damages, emotional distress, attorneys' fees, etc. As a result, CTR cannot guarantee that awards will be considered "reasonably allocated" for tax purposes. Therefore, CTR has determined that all lump sum employment awards (including awards that include emotional distress or other compensatory damages) will be processed as "wages" through HR/CMS and subject to state and federal income tax withholdings, and Medicare tax (unless the employee is exempt) prior to payment to the claimant or claimant's attorney, unless it is clear that no part of the settlement could be considered wages.

This conservative approach to tax withholding does not change the ultimate taxability of the payment to the claimant, it simply ensures that the Commonwealth is properly reporting and meeting its tax withholding obligations. In addition, the Commonwealth has found that this treatment is considered "claimant-friendly" by ensuring that most (if not all) of a claimant's tax responsibilities for these amounts are fulfilled at the time of payment, rather than deferring tax obligations until the end of the tax year when the claimant is then subject to tax liabilities related to these awards, including potential penalties for failure to pay "estimated tax payments" in the tax quarter in which the payment is received. See the IRS statement on Settlements and Taxability in which they state: "*Some settlement recipients may need to make estimated tax payments if they expect his/her tax to be $1,000 or more after subtracting credits & withholding. Information on estimated taxes can be found in IRS Publication 505, Tax Withholding and Estimated Tax, and in Form 1040-ES, Estimated Tax for Individuals*."

Lump sum awards for current and former employees are paid through HR/CMS. Withholdings are as follows:

1. **State income tax**
2. **Federal income tax**
3. **Medicare tax**

   Department needs to check if the employee was subject to Medicare tax on the last payroll period paid. If exempt, uncheck Medicare box so that Medicare is not taken out (applies only if employee was hired prior to April 1, 1986 with no subsequent break in service).

4. **Existing automated wage garnishments for child support, tax liens, student loans etc.**

   Departments and their attorneys should request certification of any outstanding debts owed to the Commonwealth. Outstanding child support or tax liens should be identified in addition to any wage garnishments already in place. Debt repayment should not be considered in award calculations to increase amounts of claims to offset the debts.

   No retirement contributions are made for this type of payment.

Tax Reporting for Non-Employee Lump Sum Awards

Lump sum awards for non-employees are paid through the Commonwealth's enterprise financial accounting and reporting system and reported to the claimant on a Form 1099-MISC (Box 3), unless the amount is less than $600 or the claimant is a corporation. If the payment is made solely or jointly to claimant's attorney or a third party, additional reporting will be required for these additional payees. Negotiating that payments be made solely to the claimant's attorney or a third party does not shift the tax or tax reporting responsibilities to the attorney or third party but merely adds additional reporting responsibilities for the Commonwealth.

Tax Reporting for Civil Rights Claims – With Claim of Personal Injury or Personal Sickness

Some civil rights claims identify a tort-like damage with resulting personal injury or sickness and are filed in state or federal court under a law other than the Massachusetts Tort Claims Act (M.G.L. c. 258). Civil rights claims that include a claim of personal injury or personal sickness are not automatically exempt from tax reporting or exempt from taxes. When there is ambiguity as to tax withholding or tax reporting responsibilities, or there are risks of potential tax withholding penalties for either the Commonwealth or claimants, CTR generally will default in favor of withholding and tax reporting.

Attorney Fees and Costs

Amounts awarded separately as "attorney fees" or "costs" are usually paid directly to the claimant's attorney through the Commonwealth's enterprise financial accounting and reporting system and are tax reportable to the attorney under a Form 1099-MISC (Box 10). If damages are also being made

payable jointly to the attorney and claimant, these amounts may be consolidated into a single check to the attorney.

Attorneys' fees are tax reportable to the claimant on a Form 1099-MISC (Box 3). These amounts are not considered "wages" and will not be subject to withholdings prior to payment. See Rev. Rul. 80-364, 1980-2 C.B. 294. Attorneys' fees awarded in a class action settlement will not be considered income, nor will awards to multiple claimants when the fees cannot be attributed to any specific claimant. See IRS Priv. Ltr. Rul. 200518017 (Jan. 3, 2005).

Additional Tax Reporting for Attorney or Third Party if Sole Payee or Co-Payee on Payment

Tax reporting is required for all payees on a check, unless the type of payment is exempt. Thus, the Commonwealth is required to issue a Form 1099-MISC (Box 10) for an attorney, or a Form 1099-MISC (Box 3) for any other third party, who is identified as the sole or co-payee of a payment, in addition to issuing a Form W-2 or Form 1099-MISC to the claimant.

Departments making settlement or judgment payments to a claimant that include the attorney as the sole or co-payee on the check must obtain an IRS Form W-9 from the attorney (if the attorney is not already on the Commonwealth's enterprise financial accounting and reporting system Vendor/Customer "VCUST" file) and make the payment using the appropriate object code.

Attorneys' fees and costs must be specified by name and amount in a settlement or judgment document in order to be paid directly to the attorney. Attorneys' fees are paid directly to the attorney or firm through the Commonwealth's enterprise financial accounting and reporting system under the TIN or Employer Tax Identification Number (EIN) of the attorney or firm. If a claim includes other payments that are being made jointly to the claimant and attorney, these amounts will normally be consolidated into a single check made payable jointly to the claimant and attorney. Attorneys cannot avoid tax reporting of awarded attorneys' fees by requesting that the check be made paid solely to the claimant.

> **Example:** Claimant is awarded $5,000 in damages and $2,000 in attorneys' fees. The $2,000 in attorneys' fees must be made payable directly to the attorney or jointly to the claimant and the attorney along with the $5,000 in damages. The $2,000 in attorneys' fees cannot be made payable solely to the claimant.

Limited Tax Exemption for Attorneys' Fees and Costs for Unlawful Discrimination Claims and Class Actions

The American Jobs Creation Act permits a limited deduction for attorney fees and costs paid in connection with certain, specified unlawful discrimination claims. See I.R.C. § 62(e); IRS Publication 525, Taxable and Nontaxable Income.

DOR has adopted the federal deduction allowed for attorneys' fees and court costs paid to recover a judgment or settlement for a claim of unlawful discrimination, up to the amount included in gross income for the tax year from such claim. See TIR 05-16.

If the claim was not filed under an unlawful discrimination statute, the exemption may not apply. Attorneys' fees awarded to a limited group of specifically named claimants who can be individually identified will be reported at the pro rata amount of the attorneys' fees divided by the number of claimants, if an individual claimant's pro rata amount exceeds $600 (unless the claimant is a corporation).

Interest on Damages and Attorney Fees

Interest on settlements or judgments is tax reportable (Form 1099-INT) if the amount exceeds $10 and the payee is not an exempt recipient (corporation, tax exempt organization, etc.). See Instructions for Form 1099-INT.

Interest payable under an employment claim is not considered "wages" and is not subject to tax withholding prior to issuing payment. If other amounts are being processed to a current or former employee through the payroll system, the interest payment can also be processed through the payroll system and included within the check or direct deposit for that employee. A manual Form 1099-INT will be issued to the claimant. If other amounts are not being processed through HR/CMS, but are payable to the employee through the Commonwealth's enterprise financial accounting and reporting system, the interest will be payable under a separate object code (E29) and included in the check or EFT to the claimant, and the Commonwealth's enterprise financial accounting and reporting system will generate a Form 1099-INT for the amount of interest that exceeds $10. If interest is to be paid along with other amounts payable jointly to an attorney and claimant, the Form 1099-INT will be issued under the same TIN as the payee (which is usually the law firm).

Note: The IRS states, "Any interest associated with an award or settlement is always taxable. Aames v. Commissioner, 94 T.C. 189 (1990); Kovacs v. Commissioner, 100 T.C. 124, aff'd, 25 F.3d 1048, cert. denied, 513 U.S. 963 (1993); Brabson v. United States, 73 F.3d 1040 (10th Cir. 1996). Some states have enacted statutes requiring defendants to pay judgment interest in tort actions. Where the parties settle an appeal of a verdict, the Service has been successful in convincing the courts that a portion of the proceeds should be allocated to such interest." Delaney v. Commissioner, 99 F.3d 20 (1st Cir. 1996), aff'g T.C. Memo.1995-378. See pp. 18-19 http://www.irs.gov/pub/irs-utl/lawsuitesawardssettlements.pdf.

Interest will be calculated based upon the date of payment and will be made payable either to the claimant (through HR/CMS or the Commonwealth's enterprise financial accounting and reporting system as determined by CTR) or the claimant's attorney (for interest on attorneys' fees or as part of a joint check) through the Commonwealth's enterprise financial accounting and reporting system. CTR will issue a Form 1099-INT to the payee receiving the interest.

Interest will either be awarded as a specified amount or will be calculated at the time of payment in accordance with the rates specified in the settlement or judgment, or as specified by statute.

Interest on a claim is calculated at a weekly rate based upon the index cited in the claim or as identified by the department or as specified by statute. If no index or interest rate is cited in the claim or by statute, CTR will use the One Year Constant Maturity Treasury Yield published by the Federal Reserve for the week of payment. See http://www.federalReserve.gov/releases/h15/.

Non-tax Reportable Damages

M.G.L. c. 258 Tort Claims - Liability Management and Reduction Fund

The Liability Management and Reduction Fund (LMRF) is used to pay costs that departments incur as a result of non-employment-related tort claims under G.L. c. 258. Tort claims are claims for damages or loss of property, personal injury, or death caused by the negligence, wrongful act or omission of a state or special employee(s) acting within the scope of the employee(s)' authority. All legal costs associated with M.G.L. c. 258 claims are paid through the LMRF and are charged back to departments over a 5-year period, pursuant to M.G.L. c. 7A, § 16 and the Liability Management and Reduction Fund - Tort Claim Policy.

Wrongful Conviction Settlements under M.G.L. c. 258D

Under M.G.L. c. 258D and 26 U.S.C. § 139F, wrongful conviction settlements are not subject to state or federal taxation. See Wrongful incarceration FAQs.

Claims Not Subject to Tax Reporting or Taxes for Claimant

The full amount of any settlement or judgment will be included in the calculation of claimant's gross income unless the payment falls within a tax reporting exception. The Commonwealth is not required to file tax reports for a claimant for the portion of a claim that represents the following:

a. Property Damage Torts

Non-employee tort claims under M.G.L. c. 258 for reimbursement of actual damages for repair or replacement costs for property damages. The procedures regarding these payments are set out in the Liability Management and Reduction Fund – Tort Claim Policy. Please refer to that policy for additional information.

b. Property Damage Torts – Subrogation

Non-employee G.L. c. 258 tort claims subrogation reimbursements to an insurer for actual damages repair or replacement cost for property damages. The procedures regarding these payments are set out in the Liability Management and Reduction Fund – Tort Claim Policy. Please refer to that policy for additional information

c. Personal Injury Torts

Non-employee G.L. c. 258 tort claims damages on account of personal physical injuries or physical sickness. The procedures regarding these payments are set out in the Liability Management and Reduction Fund – Tort Claim Policy. Please refer to that policy for additional information.

Tort claims for non-physical injuries or sickness are tax reportable (Form 1099-Misc in Box 3) to non-employee claimants.

Other Considerations

Claimant and Payee Tax Identification Information Mandatory Verification

As with any other payment, CTR relies on the department head's certification that the paperwork provided is accurate and complete, including tax information and verification for any payee. See the CTR Department Head Signature Authorization Policy and the CTR Vendor / Customer File and Form W-9 Policy. CTR is responsible for ensuring that payment reaches the intended recipient and that funds are not fraudulently misdirected. Therefore, CTR relies upon departments and the department counsel for verification of the legal name, legal address and TIN or Federal Employer Identification Number (FEIN) for any claimant or other payee (attorney, insurance company, estate, other third-party payee). At a minimum, the department or department counsel should obtain a written certification from claimant or counsel that the payee information is accurate and complete.

If the claimant or other payee is already in HR/CMS, the department and department counsel are responsible for identifying the correct HR/CMS employee ID, record number, position number and account associated with that position number for the employee and verifying that the legal address is still valid for Form W-2 reporting purposes. If the employee is a former employee, a Form W-9 should be obtained to verify the current legal name, legal address and TIN.

For payments to claimants and attorneys through the Commonwealth's enterprise financial accounting and reporting system, a Form W-9 is required.

For Class Actions with multiple claimants submitting substitute Forms W-9 and spreadsheets being submitted from Claim Administrators to upload to the VCUST file, the Claims Administrator must perform the required verification and certify to CTR that the information is accurate and complete. CTR will perform routine IRS data matching to identify any irregularities, invalid TINs or TIN and Name mismatches to prevent the unauthorized distribution of payments.

Records Management

Department counsel is responsible for maintaining the original or certified "Record copies" of all documents related to a claim or identifying the repository for these records in accordance with the records retention schedule published by the Supervisor of Public Records - Records Management Unit and the CTR Fiscal Records Management Policy.

CTR will retain documents submitted for administrative processing in accordance with the records retention schedule; this does not relieve department counsel from their retention obligations for these records. Public record requests for copies of documents related to a claim will be fulfilled if CTR is in possession of the requested documents. If CTR does not have a copy, it will refer the request to the department that submitted it.

Internal Controls

CTR will conduct quality assurance reviews and audits of payments made by departments using settlement and judgment codes, as appropriate. Departments are responsible for complying with this policy, and making any corrections necessary to bring settlement or judgment documentation or payments into compliance if a department finds it has made a payment contrary to CTR's instructions.

Any questions about this policy should be directed to the CTR Settlement and Judgments Team at settlement.judgment@mass.gov.