



Wood LLP

Tax Alert



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When Hacked Celebs Sue Apple, Guess Who Cashes In?

The hacking and posting of nude photographs of celebrities provoked discussion about protections from invasions of privacy. The victims included [Kate Upton](#), [Jennifer Lawrence](#), Victoria Justice, Ariana Grande, Kirsten Dunst, Mary Elizabeth Winstead, Krysten Ritter, Yvonne Strahovski, and Teresa Palmer. It turns out at least one model is suing Apple over hacking, and she is trying to turn it into a class action. Joy Corrigan is the [model who sued Apple after the leak, saying she warned Apple](#) about lax security.

Corrigan claims nude photos were stolen from her iCloud account months before Celebgate propelled stars' nude photos around the world. Apple denies responsibility, but Apple's security measures and how it reacted to warnings could come out. And while it's too soon to say if the suit has legs or if additional claimants will file, invasions of privacy can be the subject of [legal action](#) based on:

- Intrusion of solitude, meaning physical or electronic intrusion into one's private quarters;
- Public disclosure of private facts, meaning the dissemination of truthful private information that a reasonable person would find objectionable;
- False light, defined as the publication of facts placing a person in a false light, even though the facts themselves may not be defamatory; and
- Appropriation, including unauthorized use of a person's name or likeness to obtain benefits.

Public figure or not, invasion of privacy suits are common. Although most celebs may not sue Apple much less find the perpetrators, a celeb that recovers is likely to have higher damages than you or I. Yet whoever collects, you might be surprised at how much the IRS usually shares in the recovery.

If you've been through an ordeal and make a legal claim, collecting a settlement or judgment can help you feel vindicated. You may feel less so when you see how much the IRS collects. Most [damage awards and settlement payments](#) are taxed except recoveries for personal

physical injuries or physical sickness. Up until 1996, damages for *any* personal injury were tax-free, including defamation, invasion of privacy, and emotional distress.

Then Congress amended the tax law to say it had to be physical, like an auto accident. Damages for emotional distress are taxed unless the emotional distress is *triggered* by the physical injury. The IRS normally wants to see “observable bodily harm” like bruises or broken bones.

Yet stress or work may trigger physical injuries or sickness like a heart attack. Stressful conditions can also exacerbate a worker’s pre-existing illness. Thus, sometimes [physical sickness recoveries can be tax-free](#). The [tax treatment of post traumatic stress disorder \(PTSD\)](#) isn’t clear, but medical data suggests it is no mere mental state.

It is physical sickness involving measurable changes in the brain and nervous system. If there are [biological effects to traumatic events](#) and [brain scans can spot PTSD](#), recoveries should be tax-free. U.S. Taxpayer Advocate Nina Olson has argued for [treating PTSD as physical sickness](#), but the tax law is not crystal clear.

Still, it is hard to argue with the fact that an invasion of privacy can produce physical and medical trauma, including PTSD. Even the mechanics are tricky. This isn’t just question whether it’s taxed or not. There’s *how* it’s taxed.

Taxable litigation settlements get a double whammy. If you have a contingent fee lawyer, the tax law assumes you got 100% and *then* paid your lawyer his share. Sounds like a wash? Hardly. Because of tax deduction rules, you may not be able to deduct all of the legal fees.

The most surprising tax trap on attorney fees is the Alternative Minimum Tax. If a successful plaintiff reports paying taxes on their contingent fees their lawyer received, it’s usually because of AMT. Tax language in settlement documents can help materially. So can photographs, medical or psychiatric records, and anything else documenting damages.

How IRS Forms 1099 are prepared counts too, and [mistakes with Form 1099 are costly](#). Bottom line? The [taxation of damage awards](#) have huge traps for the unwary. The last thing you want is to resolve a legal battle and then, several years later, have to fight with the IRS.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.