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THE TAX LAWYER

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### **\$380 Million Gymnastics Abuse Settlement, Before Taxes?**

Over 500 female gymnasts were sexually abused by Dr. Larry Nassar when he was a national gymnastics team doctor. After years of wrangling, the gymnasts are collecting a total of \$380 million in legal settlements from USA Gymnastics and the United States Olympic & Paralympic Committee. Nassar pleaded guilty in November 2018 to seven counts of criminal sexual conduct, and admitted that he used his position to sexually abuse young girls. He was sentenced to 40 to 175 years in prison. Among the numerous abused plaintiffs were Olympic gold medalists Aly Raisman, Simone Biles and McKayla Maroney, as well as seven-time NCAA gold medalist Maggie Nichols. Harsh criticism has been leveled at the system that enabled Nassar, and at law enforcement and the FBI for the numerous ways in which they failed to handle the repeated allegations appropriately. Yet sadly, for many victims, an award of cash can come with tax worries.

Can the IRS tax this? The fact that the tax rules are shades of grey adds angst to the victim's experience. If you've been through an ordeal, you do not want to pay taxes, but you also don't want to worry about claims by the IRS or state tax authorities several years later. How lawsuit [settlements are taxed is](#)

[surprisingly complex](#). Under the tax code, compensatory damages for personal physical injuries or physical sickness are tax free. In contrast, damages for emotional injuries are fully taxable. Yet if you have emotional injuries *triggered* by physical injuries, damages for emotional injuries are *also* tax-free. It's confusing, making [taxing emotional distress and physical sickness a kind of chicken and egg issue](#). Adding to the confusion, exactly what is 'physical' is not defined, so the emotional vs. physical line in the tax law turns out to be confusing. The IRS likes to see "observable bodily harm" such as bruises or broken bones, but if you are sexually abused, you may not have these signs. In workplace harassment and abuse cases, plaintiffs often try to have their settlements classified as tax-free, but the impediments to tax treatment can be high. Although most plaintiffs lose tax cases of this sort, in one case, stressful conditions exacerbated a worker's pre-existing multiple sclerosis, which was clearly a [nontaxable physical sickness](#) recovery. Although former [President Obama seemed to agree that PTSD should qualify](#), the tax code so far does not say.



Where does sexual abuse or sexual assault stand in this equation? It may depend on how severe it is, what evidence you have, and more. Clergy sex abuse, athlete sex abuse, scouting sex abuse and in other contexts, lawsuit settlements for abuse are numbingly familiar. It seems hard to imagine the IRS pursuing sex abuse victims, but as the rules are not clear, that should be changed. The American Association of Settlement Consultants is mounting an effort to expand the tax law to *expressly* include sexual assault, sex abuse, molestation, and post traumatic stress disorder (PTSD) in the tax-free category. The IRS could perhaps make this kind of interpretive change itself, but some say that section 104 of the tax code should be amended. In the meantime, claimants struggle with the rules. On the positive side, the IRS issued one piece of non-precedential guidance that a clergy sex abuse settlement was tax-free even though the abuse occurred years before, and even though only emotional injuries could be shown.

The IRS *assumed* some of it was physical enough at the time to trigger the continuing emotional injuries years later. In that ruling, the [IRS allowed the exclusion without proof of physical harm](#). Yet it's not clear if part of the IRS rationale was that the victim was a minor and many years had elapsed between the abuse and the settlement. If you are sexually assaulted or abused, you may not have obvious outward signs like bruises. But keep whatever evidence you have, including photos, doctor reports, police reports, and more. What if you get stuck with bad wording, or even with an [IRS Form 1099 for your settlements and for the legal fees](#)? The IRS isn't bound by the parties' tax characterization, but [lawsuit taxes often hinge on settlement agreement wording](#) and the IRS often will respect it. The [IRS rules on how lawsuit settlements are taxed](#) can be confusing and seem unfair. Incredibly, in some cases now, there's a [tax on lawsuit settlements, with legal fees that can't be deducted](#). That can mean paying tax on 100%, even if 40% off the top goes to

your lawyer. If you have that bizarre situation, check out [12 ways to deduct legal fees under new tax law](#).

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