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THE TAX LAWYER

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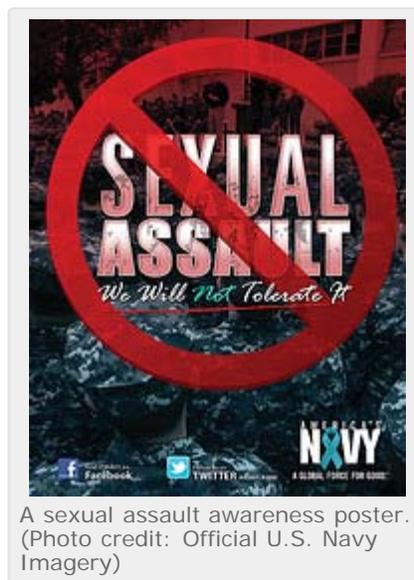
Are Sexual Assault And Sex Abuse Recoveries Taxed?

This sounds like a silly question. Surely the answer is no! Yet the question comes up frequently, the tax rules aren't black and white, and the stakes can be huge. If you've been through an ordeal, make a legal claim and eventually get a settlement or judgment, the **last** thing you want is uncertainty about taxes.

You don't want to pay taxes if you don't have to. But you also don't want to face claims by the IRS or state tax authorities several years down the line. They add interest and penalties and require you to face the legal system all over again. If you haven't saved enough from your settlement to handle the tax dispute, it can be downright devastating.

If you do have to pay tax, there's a double whammy. You might assume if you have a contingent fee lawyer that the lawyer's share isn't income to you. Actually, the tax law assumes you got 100% and **then** paid your lawyer. Because of tax deduction rules, you may not be able to deduct all of the legal fees. The most surprising tax trap on fees is the Alternative Minimum Tax. See [10 Things To Know About Taxes On Damages](#).

Under the tax code, damages for personal physical injuries or physical sickness are tax free. Damages for emotional injuries are not. Yet if you



A sexual assault awareness poster. (Photo credit: Official U.S. Navy Imagery)

have emotional injuries **triggered** by physical ones, the damages for the emotional injuries are also tax-free.

This may sound simple, but in practice can be a nightmare. One of the bones of contention is what constitutes personal physical injuries or sickness. The IRS hasn't defined it, but normally wants to see "observable bodily harm" such as bruises or broken bones. Yet if you are sexually assaulted or abused, you may not have these signs.

Keep photographs, police reports, medical or psychiatric records and anything else documenting your claim and damages. The IRS has ruled some clergy sex abuse settlements tax-free even though the abuse occurred years before and 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. See [IRS Allows Damages 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 by the settlement. To try to maximize your chances of smooth sailing, consider these steps:

1. If you haven't yet signed a release or settlement agreement, ask for payment to be described as for your "personal physical injuries, physical sickness and emotional distress arising out of such physical injuries."
2. If possible, mention the primary event, i.e., that you allege you were sexually assaulted or abused.
3. Ask that no IRS Form 1099 reporting the payment be issued to you or filed with the IRS. Payments of damages that are tax-free should **not** be reported on these forms, but if you don't get the defendant to agree in writing, one may be issued and you'll have to put it on your tax return. See [I'm Sending An IRS 1099: 1099 Are You Outta Your Mind?](#)
4. Get tax advice **before** your settlement is documented. See [Address Taxes When You Mediate Civil Disputes](#). The IRS isn't bound by the parties' tax characterization, but it is often respected if reasonable.

The interactions between physical and emotional injuries and sicknesses are starting to be explored. Some plaintiffs in employment suits have had settlements classified as tax-free. In one case, stress at work produced a heart attack. See [Is Physical Sickness the New Emotional Distress?](#) In another, stressful conditions exacerbated the worker's pre-existing multiple sclerosis. See [Tax-Free Physical Sickness Recoveries in 2010 and Beyond](#).

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