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Erin Andrews Wins \$55M Peephole Verdict But Faces Heavy IRS Tax Hit

Erin Andrews won a big [\\$55 million verdict](#) in her peephole lawsuit, but the IRS may be the big winner. The bad actor was Michael Barrett, who surely can't pay the \$28 million the verdict orders. The Marriott franchisee and operator (West End Hotel Partners LLC and Windsor Capital Group Inc.) face the remaining \$27 million, but may appeal. Even if they decide to pay, [how much will Ms. Andrews get after fees and taxes?](#)

The case may settle for around \$20 million, pointing out that there are big lawyer fees, suggests [TMZ](#). Let's say 40%. But taxes are the real problem. Damages for physical injuries (say, broken bones from an accident) are tax-free under [Section 104](#) of the tax code. So are damages for physical sickness. But since 1996, your injury must be "physical" to be tax-free. The IRS says your injuries must be visible, so Ms. Andrews may be out of luck. She was humiliated and clearly suffered emotional distress. But without something considerably more 'physical,' it is all subject to tax.



Taxpayers routinely argue in Tax Court that their damages are sufficiently physical to be tax-free, but the IRS usually wins. Money you receive for physical symptoms of emotional distress (like headaches and stomachaches) is taxed, while physical injuries or sickness is not. But how one should interpret this confusing law is often debated.

In [*Parkinson v. Commissioner*](#), the Tax Court overruled an IRS decision to tax a \$350,000 settlement a man received after suing his ex-employer for intentional infliction of emotional distress. The distress led to a heart attack, so counted as tax-free physical sickness. In [*Domeny v. Commissioner*](#), the Tax Court ruled that a settlement was partially tax-free where an employee had physical sickness from working conditions. Stressful conditions exacerbated her pre-existing multiple sclerosis.

How about post-traumatic stress disorder? There is debate whether [PTSD a physical injury for tax purposes](#), but the tax treatment of PTSD isn't clear. Taxpayer Advocate Nina Olson has suggested [treating PTSD as physical sickness](#), but it isn't clear how the IRS would rule. Staying off the IRS radar is usually desirable. How a settlement is reported to plaintiffs on IRS [Forms 1099](#) influences the tax treatment too. So does the exact wording of a settlement agreement. The IRS isn't bound by that wording, but it can help.

From a tax viewpoint, Ms. Andrews may be better off settling. At least in a settlement the parties can try to agree about the tax issues and tax reporting. Attorney fees can be a tax trap, too. When a plaintiff uses a contingent fee lawyer, the plaintiff is treated (for tax purposes) as receiving 100% of the money, even if the defendant pays the lawyer directly. If the case is fully nontaxable (say an auto accident in which you're injured), that won't cause any tax problems. But if your recovery is taxable, watch out.

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Say Ms. Andrews settles her suit for \$20 million. Say her lawyer gets \$8 million. You might think that she has \$12 million of income. Actually, though, she probably would have \$20 million of income. Then, she might have to claim her \$8 million of legal fees as a miscellaneous itemized deduction. That triggers multiple tax traps, including the alternative minimum tax or AMT. When people talk of paying tax on money they never see, the AMT is often responsible.

If the breakdown of Ms. Andrews verdict turns out to be punitive rather than compensatory damages, she may face an even harsher tax result. Punitive damages and interest are always taxable, even in a *bona fide* physical injury case. And you can have trouble deducting your attorney fees too. Ms. Andrews should be applauded for fighting back and pushing for legal responsibility in this case. But from a financial viewpoint, she may end up with a much smaller amount of money to show for it than you might think.

For alerts to future tax articles, email me at Wood@WoodLLP.com. This discussion is not legal advice.