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Hush Money And Taxes: 7 Things To Know (Shhh!)

Hush money sounds dirty or even illegal. But on some level, nearly all businesses pay it on occasion. And these days, everyone in business should know certain key rules. Consumers should too.

1. Hush Money is Income. If you get paid hush money, is it income you have to report on your taxes? You bet. The IRS says *everything* is income. That certainly applies to hush money, whatever the circumstances. In fact, almost all legal settlements are income. There are a few exceptions, mainly for personal physical injury damages. But the IRS is pretty strict about what qualifies as physical. Even then, that is only for the *compensatory* damages, not punitive damages or interest.

Once it's income, it is hard to avoid taxes. [Stormy Daniels had income, even if she returned the \\$130K Trump settlement](#). So be careful. And attorneys' fees are often treated as taxable income to the plaintiff, even if the lawyer takes the fees off the top! It's one way the [Trump tax law hurts legal settlements](#).

2. Defendants Deduct It. Businesses routinely settle legal claims of all sorts to keep claims and amounts quiet. No business wants bad publicity, and lawsuits are bad for business. So are settlements, especially if amounts are publicized. Settlements that become public can encourage *other* claims to be brought. So just about *every* legal settlement agreement *requires* confidentiality. It's part of the deal. You can say that the business is paying the claim, or paying for silence. It might be a bit of both. If the company paying the money is in business, it is almost always tax deductible, well, until recently.

3. Individual Defendants Usually Can't Claim a Write-off. Companies routinely pay hush money. Individuals do so less frequently, even though individual conduct at companies probably leads to most of the liabilities the hush money is intended to cover up. To claim a write off, an individual would have to be conducting a trade or business. Plus, the hush money would have to relate to that trade or business. For an individual, that can be a tall order.

4. Hush Money for Sex Harassment. Starting in 2018, a new tax law says businesses and individuals can no longer write off confidential legal settlements for sex harassment or abuse. The restrictions only apply if confidentiality is *required*. So if you just pay hush money but do not *expressly* call for nondisclosure or confidentiality, companies can still write it off. Some companies are doing that now (settling *without* requiring confidentiality) to get around the new rules. But most companies seem willing to forgo a tax deduction to keep the settlement quiet. For example, [Fox settled some suits without confidentiality](#).

5. Legal Fees Can Be a Problem. For businesses, legal fees are *almost always* tax deductible, even if the legal fees are *very* expensive. They are just one of numerous business expenses. But starting in 2018, if you are paying hush money for sex harassment or abuse, *and* if you require confidentiality, not even the legal fees can be deducted.

6. Recipients of Hush Money Have Tax Problems Too. If you a *receiving* money and your claims were for sex harassment or abuse, you will probably be asked to sign a confidentiality provision. You might think only the defendant would face tax restrictions from this. But plaintiffs can have tax problems too, perhaps not being able to deduct their legal fees. A plaintiff in a \$500,000 sex harassment settlement might pay her lawyer \$200,000, netting only \$300,000. But she may be taxed on the full \$500,000. There's currently a movement to change this unintended and harsh result. In short, the [tax law that double-taxes victims needs fixing](#).

7. Be Careful of End Runs. With many sex harassment claims settled all the time, parties are already attempting to get around these rules. For example, in a \$1M settlement, how about saying that only \$50,000 is for 'sex harassment?' No one know yet whether these workarounds will actually work. On the plaintiff side, [legal settlements with tax indemnities are on the rise](#),

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.