

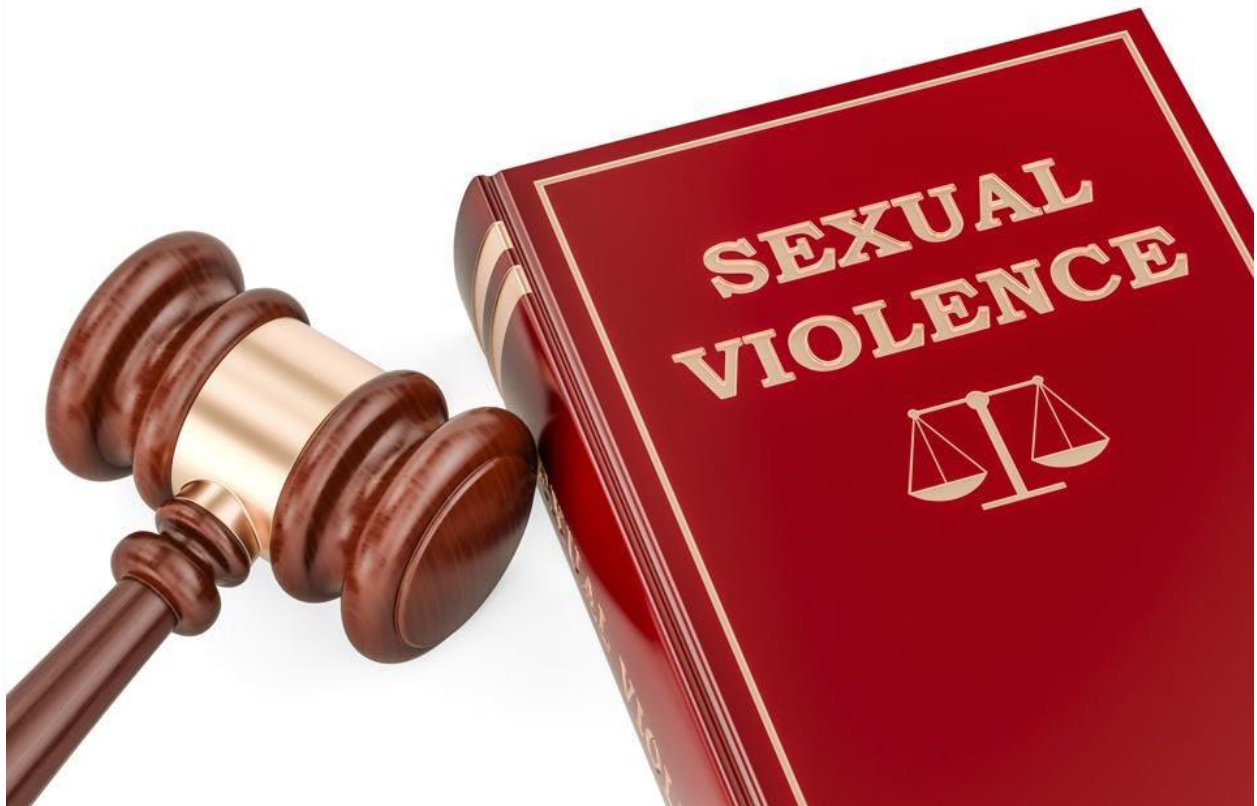


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Tax Bill Would Exempt Sex Abuse And Assault Settlements From IRS Taxes



Should sexual assault and abuse legal settlements be taxed by the IRS? Most people would answer no, yet the tax law has long been unclear. How lawsuit [settlements are taxed is 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. It's confusing, making [taxing emotional distress and physical sickness a kind of chicken and egg issue](#).

If you've been through an ordeal and eventually collect a settlement or judgment, the last thing you want is uncertainty about taxes. You do not want to pay taxes if you don't have to, but you also don't want to face an audit and claims by the IRS or state tax authorities several years later.

Representative Lloyd Smucker (R-Pa.), a member of the House Ways and Means Committee, has introduced the Survivor Justice Tax Prevention Act (H.R. 10055), which is co-sponsored by Gwen Moore (D-Wis.), also of the House Ways and Means Committee, and Gregory Meeks (D-N.Y.). If passed, it will amend the tax code so survivors of sexual abuse and unwanted and illegal sexual contact do not have to pay taxes on their settlements. The exclusion is not retroactive, and an anti-abuse provision says that you cannot restate an existing settlement agreement to be dated after the date of enactment in order to qualify for the exclusion.

Under current tax law, compensatory payments for damages awarded on account of personal physical injuries or physical sickness are exempt from federal tax. But what constitutes physical injuries or physical sickness is not defined. The IRS likes to see "observable bodily harm" such as bruises or broken bones, but if you are sexually assaulted or abused, you may not have these signs. Sexual assault victims often face uncertainty.

The IRS has issued one piece of *non-precedential* internal guidance in which the IRS's attorneys advised an IRS agent to *presume* that a victim of an alleged assault who was a minor at the time of the assault, but was an adult when

they brought suit several years later, qualified for an exclusion. The guidance is vague, but commentators have inferred that the guidance relates to a clergy or other sex abuse settlement. In that ruling, the [IRS effectively allowed the exclusion without proof of cuts, scrapes or bruises](#). Yet it did so by *assuming* that they existed and had healed due to the passage of time, not by clarifying that they were not needed in the context of a sexual assault in the first place.

HR 10055, if enacted, would finally provide guidance and increased clarity on this topic. Smucker and Moore rightly point out that the observable harm standard can be especially difficult to meet and unfair in circumstances of sexual assault or sexual contact where such physical injuries may not be visible or may have healed. Depending on your view of whether sexual assault victims are already covered by the language in Section 104(a)(2), the proposed legislation narrowly “expands” (or merely clarifies) current law to help survivors of sexual assault or unwanted sexual contact by tying the IRS tax exemption to the definitions of sexual act and sexual contact in federal criminal code.

“Right now, sexual abuse survivors who prevail in legal actions against their abusers must pay federal tax on monetary awards they receive unless they prove to the IRS they suffered physical harm. I am honored to partner with Representative Smucker to remove the burdensome and unfair requirement on survivors of sexual abuse and highlight our joint work during Domestic Violence Awareness Month,” Moore said.

“This legislation provides certainty for survivors of sexual assault and ensures that monetary settlements are exempt from federal income tax. I encourage my colleagues to stand with survivors by supporting this narrowly tailored legislation. I want to thank Rep. Gwen Moore for joining me introducing this legislation,” Smucker said.

A Specific, Well-Worded Proposal

Tax legislation is not easy to write, and many tax bills fail to gain traction and fail to pass. In some cases, one reason is the language in the bill itself. But this tax bill—apart from its equity—is extremely specific. It would implement the exclusion by amending Section 104(a)(2) of the Internal Revenue Code to include within the ambit of the existing exclusion amounts (other than punitive damages) received by a taxpayer on account of a “sexual act” or “sexual conduct.” The definition of sexual act and sexual contact are clearly identified as referring to definitions of the same terms under 18 USC 2246. Here are the relevant definitions in that provision:

(2) the term “[sexual act](#)” means—

(A) contact between the penis and the vulva or the penis and the anus, and for purposes of this subparagraph contact involving the penis occurs upon penetration, however slight;

(B) contact between the mouth and the penis, the mouth and the vulva, or the mouth and the anus;

(C) the penetration, however slight, of the anal or genital opening of another by a hand or finger or by any object, with an intent to abuse, humiliate, harass, degrade, or arouse or gratify the sexual desire of any person; or

(D) the intentional touching, not through the clothing, of the genitalia of another person who has not attained the age of 16

years with an intent to abuse, humiliate, harass, degrade, or arouse or gratify the sexual desire of any person;

(3) the term “[sexual contact](#)” means the intentional touching, either directly or through the clothing, of the genitalia, anus, groin, breast, inner thigh, or buttocks of any person with an intent to abuse, humiliate, harass, degrade, or arouse or gratify the sexual desire of any person;

Leaving aside the cases of abuse and assault that do produce documented cuts, bruises, and scrapes, which clearly and appropriately are covered by the IRS’s rulings regarding the existing exclusion language in Section 104(a)(2), it is worth considering some of the fact patterns involving sexual abuse whose tax treatments are more ambiguous under current law. For example, under the definition in the proposed legislation, the groping of a person’s buttocks, inner thigh, or breast even “through the clothing” is sexual contact, so a settlement would therefore be excludible.

The bill also specifically provides that it is enough to qualify for the exclusion if the judgment or settlement agreement states that the damages are for an alleged sexual act or sexual conduct. It goes on to say that the IRS or a court cannot use a lack of medical records about the groping or other incident occurred to deny tax-free treatment. It would seem difficult for the IRS to be able to impose a cut, bruise, or scrape requirement on sexual abuse recoveries with this language.

Cases that are already settled and monies that are already paid will not be covered by this tax bill. Those plaintiffs need to take tax positions under the current Section 104(a)(2) language. Getting to an acceptable tax position that their recoveries are excludible as amounts received on account of a physical

injury may still be possible in many cases, despite the current ambiguity in the tax law.

The interactions and overlap between physical and emotional injuries and sicknesses are starting to be more thoughtfully explored in tax law. In one employment case, stress at work produced a heart attack. In another, stressful conditions exacerbated the worker's pre-existing multiple sclerosis, which the Tax Court found to be a [nontaxable physical sickness](#) recovery. [Damages for PTSD](#) may also qualify. Until the pending tax bill passes, plaintiffs in current sex abuse or sexual assault cases might consider the following:

- If you have not yet signed a release or settlement agreement, ask for payment to be described as for your “personal physical injuries, physical sickness and emotional distress therefrom.”
- If possible and to the extent you feel comfortable, mention the primary event, i.e., that you allege you were sexually assaulted or abused. At a minimum, it may be worth describing your allegations as including unwanted “sexual contact” or an unwanted “sex act,” if you feel comfortable doing so, since those are the words used in the proposed new language.
- Ask that no IRS Form 1099 reporting the payment be issued to you or filed with the IRS. Forms 1099 are only supposed to report the amount of a payment that is gross income for tax purposes to the recipient. Payments of damages that are tax-free should *not* be reported on these forms, treasury regulations and several IRS rulings confirm. If you don't have a commitment, you might be issued a form and would need to report or explain it. Having to explain your exclusion in an audit means having to discuss the details of your sexual assault in yet another

uncomfortable and official forum, so it is appropriate both legally and for your own privacy and mental health to insist on not being issued a Form 1099 when your recovery is tax-free.

- If possible, get tax advice *before* your settlement is documented, including [when mediating your dispute](#). 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.

Hats off to Representatives Gwen Moore, Lloyd Smucker, and Gregory Meeks for bringing forth this proposal.

Check out my [website](#).