



Robert W. Wood

THE TAX LAWYER

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IRS Tax On Sexual Abuse Victims Needs Clarification

Sex abuse and legal settlements to provide a limited form of redress are common, and yet the way in which such recoveries are taxed remains cloudy. Whether arising from clergy sex abuse, athlete sex abuse, scouting sex abuse or in other contexts, lawsuit settlements for abuse have become numbingly familiar. In many of these, the claims process is slow and bureaucratic, with an eventual award of cash. But what has the victim received when they “win?” In most cases, is it money and hopefully some form of closure of very painful events. Sadly, though, for many victims, the award of cash comes with tax worries too. Can the IRS tax this? The answer is nuanced, adding more angst to the victim’s experience. The tax rules are not black and white, and the stakes can be huge. If you’ve been through an ordeal 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 claims by the IRS or state tax authorities several years later. That can 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 devastating. The law should be clarified to make clear that these recoveries will not be taxed.



In the meantime, the IRS has issued one piece of non-precedential guidance that a clergy sex abuse settlement was tax-free even though the abuse occurred years before, and even though only emotional injuries could be shown.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 by the settlement. To try to maximize your chances of smooth sailing, consider these steps:

1. 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.”
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. If you don't have a commitment, you might be issued a form and need to report or explain it.

4. 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.

Under the tax code, damages for personal physical injuries or physical sickness are tax free. Damages for emotional injuries are not. Yet if you have emotional injuries *triggered* by physical ones, the damages for the emotional injuries are also tax-free. What constitutes personal physical injuries or sickness is not defined, but the IRS likes 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. 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. In another, stressful conditions exacerbated the worker's pre-existing multiple sclerosis, which was clearly a [nontaxable physical sickness](#) recovery. [damages for PTSD](#) may also qualify. Minimizing the tax is important, as if you do have to pay tax, there's a double whammy. Because of tax deduction rules, if a recovery is taxable, you may not be able to deduct all of the legal fees.

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