PERSPECTIVE

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New Tax Rules Could Swallow Up Much of the Monsanto Verdict

By Robert W. Wood

If you get cancer from an allegedly harmful product, are damages won in a personal injury lawsuit taxable? Your first reaction is to say of course not. We all know that damages for personal physical injuries and physical sickness are not supposed to be taxed. But it is easy to forget that this rule is only for compensatory damages.

The exclusion from taxes doesn't cover punitive damages or interest. And if you think about the legal fees, that adds another lawyer of tax complexity that got a lot worse starting in 2018. That is where our Roundup story begins. Another Roundup verdict against Monsanto is in, this time about $80 million.

Jurors found that Monsanto failed to warn users its product was dangerous and awarded Edwin Hardeman $200,000 for economic losses, $5 million for past and future pain and suffering, and $75 million in punitive damages. Last year, jurors gave $289 million to a man they say got cancer from Monsanto's Roundup. That verdict was later reduced, and is on appeal.

The latest case is federal, and suggests that others could be headed for big numbers. The jury had already concluded that the weedkiller was a substantial factor in causing Mr. Hardeman's non-Hodgkins lymphoma. Monsanto faces over 10,000 claims, and can be expected to continue fighting hard.

Yet even if Monsanto pays up, new tax rules could swallow up many of the verdicts plaintiffs might be hoping to collect. The new tax math under President Donald Trump's tax bill can be onerous.

The big tax law was passed in late 2017. *See* Tax Cuts and Jobs Act, P.L. 115-97. Amazingly, many legal fees can no longer be deducted. That means many plaintiffs must pay taxes even on monies their attorneys collect. Of course, the attorneys must *also* pay tax on the *same* money.

I'll make some assumptions here, and try to apply the new math. Mr. Hardeman was awarded a bit over $5 million in compensatory damages, and $75 million in punitive damages. The combined contingent fees and costs Mr. Hardeman pays his attorneys might total as much as 50 percent.

Based on those assumptions, the plaintiff would get to keep half, or $2.5 million of the $5 million compensatory award. Since it is for his claimed non-Hodgkin's lymphoma, that part for physical injuries should presumably not be taxed. That sure sounds like physical injuries or physical sickness to me.

Of the $75 million punitive award, let's apply my assumed 50 percent split. That means $37.5 million goes to legal fees and costs, and $37.5 million to Hardeman. So *before* taxes, the plaintiff's take home is $40 million. So far, so good.

But what about *after* taxes? The $75 million in punitive damages would be fully taxable, with *no deduction* for the fees to his lawyer. Between federal taxes of 37 percent and California taxes of up to 13.3 percent, Hardeman could lose about 50 percent to the IRS and California Franchise Tax Board. In the old days, California taxpayers could write off their California taxes when filing their federal return.

Now, of course, there is a $10,000 limit on deducting state taxes. And you have to consider property taxes as well as income taxes in that limit. So, the idea that a tax deduction could blunt the sting of paying California tax, is mostly out the window.

If the money plays out as I am suggesting, the big federal and state taxes could make Mr. Hardeman's after-tax (and after legal fee) haul from an $80 million verdict only $2.5 million. Does that seem fair? Most people would say no. Besides, most people would be just plain shocked.

$2.5 million isn't pocket change, but it is still an astounding result. Besides, being taxed on money you do not receive seems downright un-American. The shocking result comes from the Trump tax law, which kills off tax deductions for many legal fees. Compensatory damages for physical injuries or physical sickness are still tax-free.

However, exactly what injuries are "physical" can sometimes seem like a chicken or egg issue. And when punitive damages or interest enter the picture, many plaintiffs simply cannot deduct the related legal fees, so are taxed on their gross, even if the lawyer is paid first. According to the Supreme Court, if you are the plaintiff with a contingent fee lawyer, the IRS treats you as receiving 100 percent of the settlement or judgement.

This is so even if the defendant pays your lawyer directly. If your case is fully nontaxable, that causes no tax problems. But if your recovery is taxable, all *or in part*, you could be taxed on more money that you actually collect. Up until the end of 2017, you could claim a tax deduction for your legal fees.

In 2018 and after, there is *no* deduction for these legal fees. The good news is that not all lawyers' fees face this terrible tax treatment. If the lawsuit concerns the plaintiffs' trade or business, the legal fees are a business expense. If your case involves claims against your employer, or certain whistle-blower claims, those legal fees are also still deductible.

However, in other cases, you are out of luck unless you are awfully creative. There may be arguments at tax time, but often you would need to plan ahead at the time a case is being resolved. Settling a case almost always gives you more flexibility from a tax viewpoint.

With these and other tax matters, there are sometimes ways to alter the bottom line, but you'll need sophisticated tax help, and nothing is foolproof. Plaintiffs and their lawyers may have to be creative, so tax lawyers are busy.

The tax issues, of course, are hardly limited to Roundup cases. Anytime punitive damages or interest are involved, be extra careful. Bad times for clients to find out about these issues include when they are doing their tax returns or when they have a tax dispute with the IRS. Even getting a Form 1099 you don't expect can be bad timing too.

Robert W. Wood *is a tax lawyer with www.WoodLLP.com, and the author of "Taxation of Damage Awards & Settlement Payments" (www.TaxInstitute.com). This is not legal advice.*