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THE TAX LAWYER

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Alex Jones Gets $49.3M Tax Write Off, Plaintiffs Have To Pay IRS Tax On Verdict

A Texas jury rendered a verdict in Alex Jones' defamation trial, ordering Jones to pay $45.2 million in punitive damages plus $4.1 million in compensatory damages to Neil Heslin and Scarlett Lewis, parents of a 6-yearold boy killed in the Sandy Hook school shooting. Jones broadcast false claims that the shooting was staged by "crisis actors." Jones says that he will appeal, and even if he loses, appeals take time. Sometimes even after a verdict, a lower settlement is reached, since collecting on a big verdict can be difficult, expensive and time-consuming. It's not clear how many assets Jones has, although Roger Stone has already started a campaign to raise money for him. But if Jones ever pays, many Americans might be surprised at the tax rules at play. Jones's business model may not be to everyone's liking, but if he makes money from his broadcasting operations, these are probably business expenses. In contrast, the plaintiffs probably have to pay tax on all of it. Does that mismatch seem fair? All punitive damages are taxable ordinary income, even for death or serious injury. That is why even Roundup Weedkiller cancer victims can face IRS taxes when they sue. The IRS even taxes fire victims.

Even worse, there is a tax on litigation settlements, with no deduction for legal fees in some cases. Amazingly, many legal fees can't be deducted, so plaintiffs may pay tax even on monies their attorney collects, even though the attorney must *also* pay tax on the same money. If you are a plaintiff with a contingent fee lawyer, the IRS treats you as receiving 100% of the money, even if the defendant pays your lawyer *directly*. Plaintiffs have to get creative to deduct their legal fees under a 2018 tax law just to get back to even.

Why are the plaintiffs likely taxable here even on the compensatory damages? After all, their son was killed, which was clearly a wrongful death. But the suit against Jones was a defamation case, where the injuries are in the nature of emotional distress, not physical injuries. Recoveries for physical injuries and physical sickness are tax-free, but symptoms of emotional distress are taxed. Since 1996, the tax code says your injury must be "physical" to be tax free. If you sue for intentional infliction of emotional distress, your recovery is taxed and even physical symptoms of emotional distress (like headaches and stomachaches) are taxed. The rules can make some tax cases chicken or egg, with many judgment calls. Many plaintiffs take aggressive positions on their tax returns, but that can be a losing battle if the defendant issues an IRS Form 1099 for the entire settlement. Haggling over tax details before you sign and settle is best.

How about Jones's tax write off? How damages are taxed is a complex subject, but business expenses are less so. Way back in 1961, President John F. Kennedy said, "The slogan — 'It's deductible' — should pass from our scene." JFK made the comment about expense accounts and business entertainment, but it has broader application and still seems timely more than half a century later. Compensatory settlements by businesses are clearly deductible, and even *punitive* damages are too. Tax bills have been introduced in Congress over the years to change that, but the bills never gained traction. Sometimes, even amounts paid to the government are deductible, despite corporate wrongdoing. For decades, Section 162(f) of the tax code prohibited deducting any fine or similar penalty paid to a government for the violation of any law. That includes criminal and civil penalties, as well as sums paid to settle potential liability for a fine. This sounds absolute, but the law is riddled with exceptions. To begin with, the rules cover only government payments, and some companies find ways to write off even the biggest payments. For example, BP probably wrote off a majority of its $20.8 billion out-of-court settlement for the Gulf Oil spill. The deal designated only about one quarter, $5.5 billion, as a non-tax-deductible Clean Water Act penalty.

Congress has pushed back on such practices. In 2017, the tax rules were tightened by the Trump tax reform law. But even under the new rules, it is permissible to write off certain payments of restitution or amounts paid to come into compliance with law. Some settlement agreements contain an explicit no-deduction provision. For example, when Tesla TSLA -0.4% and Elon

Musk settled with the SEC for $20 million each, a court filing said Tesla expressly agreed not to claim a tax deduction for its $20 million. Had it not been for that agreement, the tax write-offs don't seem to have been prohibited. After all, the SEC said the $40 million in penalties will be distributed to harmed investors under a court-approved process, and that sounds like restitution.

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