



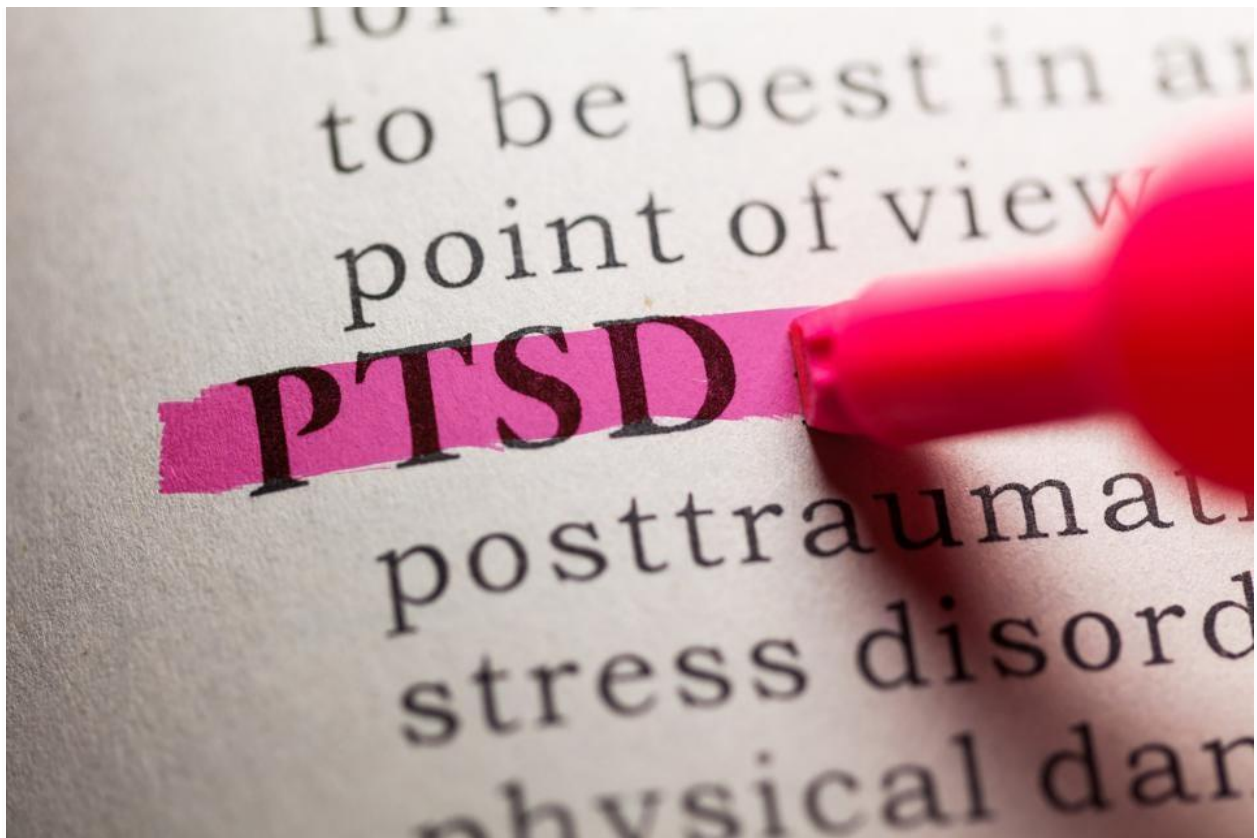
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# Dear IRS: Sexual Abuse & PTSD Settlements Should Never Be Taxed

How lawsuit [settlements are taxed is surprising and 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. Yet if you have emotional injuries *triggered* by physical ones, the damages for the emotional injuries are *also* tax-free. It's confusing, making [taxing emotional distress and physical sickness a kind of chicken and egg issue](#). Settlement wording can matter a lot, as can the complaint. Adding to the confusion, exactly what is 'physical' is not defined. The IRS generally likes to see observable bodily harm such as bruises, cuts or broken bones. Yet many injuries are not as obvious but can be worse and take much longer to heal. Where does sexual abuse or sexual assault stand in this equation? It may depend on how severe it is, what evidence you have, and more. Clergy sex abuse, athlete sex abuse, scouting sex abuse and in other contexts, lawsuit settlements for abuse are numbingly familiar. Sadly, for many victims, an award of cash comes with tax worries too. Can the IRS tax it? The answer is nuanced, adding more anxiety to the victim's experience.



The American Association of Settlement Consultants is mounting an effort to expand the tax law to *expressly* include sexual assault, sex abuse, molestation, and post traumatic stress disorder (PTSD) in the tax-free category. The IRS could perhaps make this kind of interpretive change itself, but some say the statute should be amended, section 104 of the tax code. In the meantime, claimants struggle with the rules. 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 with interest and penalties. 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 In the meantime, the IRS has issued one piece of non-precedential guidance that a clergy sex abuse settlement was tax-free even though the abuse occurred years before, and even though only emotional injuries could be shown.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 between the abuse and the settlement. If you are sexually assaulted or abused, you may not have obvious outward signs like bruises. But keep whatever evidence you have, including photos, doctor reports, police reports, and more. Some victims end up with PTSD, and there are good arguments that PTSD is itself physical. Although former [President Obama seemed to agree](#), the tax code so far does not say.

What if you get stuck with bad wording, or even with an [IRS Form 1099 for your settlements and for the legal fees](#)? If possible, get tax advice *before* signing a settlement agreement, or even earlier [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. Whatever your legal matter, the [IRS rules on how lawsuit settlements are taxed](#) can be confusing, and some seem especially unfair. Incredibly, in some cases now, there's a [tax on lawsuit settlements, with legal fees that can't be deducted](#). That can mean paying tax on 100%, even if 40% off the top goes to your lawyer. If you have that bizarre situation, check out [12 ways to deduct legal fees under new tax law](#).

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