



Robert W. Wood

THE TAX LAWYER

TAXES 04/03/23

Gwyneth Paltrow's \$1 Ski Trial Win Has A Strange Tax Twist



Gwyneth Paltrow's ski accident trial was not as alluring as the [Johnny Depp and Amber Heard case](#), but it still attracted people who couldn't look away. At a minimum, it was worth losing half a day of skiing to check it out. In the end, a Park City, Utah, jury deliberated for less than three hours after being handed the case and they came down in favor of the Oscar-winning star.

Jurors awarded Paltrow \$1 in damages, ruling Dr. Terry Sanderson was 100% at fault in the 2016 collision on the slopes at Deer Valley Utah. Paltrow's accident with the retired optometrist allegedly broke his ribs and caused permanent brain damage. When Sanderson sued three years later in 2019, Paltrow claimed he crashed into *her* and filed a counterclaim, seeking just \$1 in damages and attorney's fees.

If Paltrow only got \$1 and attorney fees, how could there be a tax angle? The legal fees appear not to have been awarded yet, which not uncommonly are handled after the verdict with submissions by Paltrow's lawyers of how much time they spent, the cost and more. But when it does occur, the fees will be taxable. They are taxable to the lawyers, of course, but they are usually treated as income for tax purposes first to their client — Paltrow in this case.

That means if Paltrow is awarded \$1 plus say \$75,000 in legal fees (just to pick a low number), Paltrow has \$75,001 in income. But can't she just turn around and deduct the \$75,000 in fees on her taxes? After all, the money is going to the lawyers. Yet that does not necessarily mean that Paltrow gets a tax deduction. It turns out the tax treatment of legal fees is strangely complex, and many plaintiffs end up paying legal fees they cannot deduct.

To take an example, say you settle a suit for intentional infliction of emotional distress against your neighbor for \$100,000, and your lawyer keeps \$40,000. You might think you'd have \$60,000 of income. Instead, you'll have \$100,000 of income, even if your lawyer takes the fees off the top and just sends you the \$60,000. The U.S. Supreme Court in [*Commissioner v. Banks*](#) held plaintiffs have income of 100% of their recoveries, even if their lawyers take a share.

How about deducting the legal fees? Sure, you can deduct the fees if you qualify, but many people do not. There is a deduction for legal fees in employment claims and certain whistleblower claims, but outside of these two areas, there's trouble. In the Tax Cuts and Jobs Act passed at the end of 2017, there's a [new tax on litigation settlements, with no deduction for legal fees](#). The deduction is supposed to come back into the tax law in 2026.

In the meantime, no tax deduction for legal fees may come as a bizarre and unpleasant surprise. Many plaintiffs win or settle a lawsuit only to be surprised that they have to pay taxes. Some don't realize it until tax time the following year when an IRS Form 1099 arrives in the mail. It's even more important now with [higher taxes on litigation settlements](#).

Can Paltrow argue that the \$1 and the legal fees are for physical injuries so they shouldn't be taxed? Yes, perhaps, since recoveries for physical injuries and physical sickness are tax-free. Notably, symptoms of emotional distress are not physical. Before 1996, all "personal" damages were tax-free, so emotional distress and defamation produced tax-free recoveries. But since 1996, your injury must be "physical" and 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. If in an employment dispute you receive \$50,000 extra because your employer gave you an ulcer, is an ulcer physical, or merely a symptom of emotional distress? 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.

Paltrow could also argue that if the fees are income, they are an offsetting business expense. But the problem is this case arose out of personal activity,

not her business. How legal fees are taxed is tricky. If you are the plaintiff, you'll usually be treated (for tax purposes) as receiving 100% of the money recovered by you and your attorney, even if the defendant pays your lawyer directly his contingent fee cut. If your case is fully nontaxable (say an auto accident in which you're injured), that shouldn't cause any tax problems. But if your recovery is taxable, be careful.

Check out my [website](#).