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THE TAX LAWYER

TAXES 3/19/2016

### Hulk Hogan Wins \$115 Million Sex Tape Verdict Against Gawker, IRS Wins Too

The news that [Hulk Hogan won a \\$115 million verdict against Gawker](#) brought tears to the former professional wrestler and smiles to foes of tabloid journalism. Mr. Hogan—a.k.a. Terry Bollea—sued Gawker, its founder, and former editor for posting parts of a Hogan sex tape. The invasion of privacy suit asked for \$100 million. And it isn't over yet.

The jury awarded Hogan \$55 million in economic damages and \$60 million for emotional distress. Next, the jury will consider whether to add punitive damages. Gawker and the individual defendants are already promising to appeal. Nick Denton, Gawker's founder, expressed confidence in the appeal. Even so, Hogan can probably count on something, since many cases settle during the appeal process.



From a tax viewpoint, a settlement is often better than collecting a verdict. At a minimum, one can often shape the tax treatment in settlement documents. And in big cases, taxes are often a big problem. Most lawsuit recoveries are fully taxable, and how they are taxed—sometimes including the lawyers' fees—can be surprising.

Damages for physical injuries or physical sickness are tax-free under [Section 104](#) of the tax code, but the rules are strict. Until 1996, emotional distress recoveries like Hulk Hogan's were not taxed. But since 1996, an injury must be "physical" to be tax-free. Taxpayers routinely argue in Tax Court that their damages are sufficiently physical to be tax-free, but the IRS usually wins. The IRS says your injuries must be visible, so Mr. Hogan is out of luck.

How can you differentiate physical symptoms of emotional distress (like headaches and stomachaches) from physical injuries or sickness? Some plaintiffs sue once to get damages, and go to court *again* to fight the IRS. In [Parkinson v. Commissioner](#), the Tax Court overruled an IRS decision to tax a \$350,000 settlement a man received after suing his ex-employer for intentional infliction of emotional distress. The distress led to a heart attack, so counted as tax-free physical sickness.

In [Domeny v. Commissioner](#), the Tax Court ruled that a settlement was partially tax-free where an employee had physical sickness from working conditions. Stressful conditions exacerbated her pre-existing multiple sclerosis. The granddaddy of stress is post-traumatic stress disorder, but is [PTSD a physical injury for tax purposes?](#)

Taxpayer Advocate Nina Olson has urged the IRS to [treat PTSD as physical sickness](#), but the IRS has not yet weighed in. And tax uncertainty can make settling with more control a wise move. The IRS is not bound by the tax wording of a settlement agreement, but it can help. In a settlement agreement, it is often possible to influence whether and how IRS [Forms 1099](#) will be issued too.

Attorney fees can be a surprising tax trap. When a plaintiff uses a contingent fee lawyer, the plaintiff is treated (for tax purposes) as receiving 100% of the money, even if the defendant pays the lawyer directly. If the case is fully nontaxable (say an auto accident in which you're injured), that won't cause any tax problems. But if your recovery is taxable, watch out.

Say Hulk Hogan settles his suit for \$50 million. Say his lawyer gets 40% or \$20 million. You might think that he has \$30 million of income to report to the IRS. Actually, though, he probably would have \$50 million of income. Then, he might have to claim his \$20 million of legal fees as a miscellaneous itemized deduction. That triggers multiple tax traps, including the alternative minimum tax or AMT. When people talk of paying tax on money they never see, the AMT is often responsible.

If Hulk Hogan ends up with some punitive damages too, he may face an even harsher tax result. Punitive damages and interest are always taxable, even in a *bona fide* physical injury case. And you can have trouble deducting your attorney fees too. The tax rules for litigants—even successful ones like Hulk Hogan—are complex. Like professional wrestling, there's more than meets the eye.

Although Hulk Hogan must feel vindicated right now, from a financial viewpoint, he may end up with smaller amount than you might think. In fact, \$115 million could be cut down to \$37 million. Let's assume he is paying 40% to his lawyer. He may not be able to deduct his lawyers' fees for purposes of the AMT.

That means he is taxed on the whole \$115 million—even the money paid to his lawyer—at the 28% AMT rate. So, after paying lawyers and the IRS, Hogan's take could be as small as \$37 million on that whopping \$115 million verdict. It is early yet, and I'm speculating. Still, any way you slice it, the IRS is going to figure prominently in the end result.

*For alerts to future tax articles, email me at [Wood@WoodLLP.com](mailto:Wood@WoodLLP.com). This discussion is not legal advice.*