

# Johnny Depp and Amber Heard Face Taxes Too

By Robert W. Wood

Legions of adoring fans tuned in daily to watch the spectacle as Johnny Depp and Amber Heard were locked in a tit for tat defamation case. It seemed like a continuation of a divorce case, and in some ways it was. One can argue that there was no real winner, since the case drug each actor through the mud in one way or the other.

On the other hand, it's clear that Depp emerged victorious on the dollars, and he clearly felt vindicated, with some of his tarnished reputation restored. Maybe he'll add to his box office dollars too, although that remains to be seen. The drama might just move on to a sequel, as Heard has already vowed to appeal, and her fans believe that she got a raw deal.

Perhaps she did, but her fans may have another upset looming when they consider the taxes at stake here, since Heard in particular faces tax problems too. Talk of any exchange of money seems premature, despite the verdict. Heard's lawyer has said that she will appeal, and that she cannot afford to pay Depp in any event. Even so, if you consider the former couple's legal fees and how they are likely to be taxed, that seems another way that Depp ends up better off.

The jury found that Heard defamed Depp, and awarded him \$10 million in compensatory damages and \$5 million in punitive damages. Depp's \$5 million in punitive damages were cut to \$350,000 under the Virginia state law cap on punitive damages. But Heard won something too, as the jury also found that Depp defamed Heard with one statement his attorney made. For that, Heard was awarded \$2 million in compensatory damages.

Thus, the final tally before Heard's appeal is Depp \$10,350,000, and Heard \$2M. Even if you aren't good at math, that's a \$8,350,000 net payment to Depp. Those sound like big numbers, but keep in mind that Depp sought \$50 million in damages, and Heard sought \$100 million. Taxes can be complex, but you might assume that taxing the Depp-Heard verdict would be straightforward.

Unfortunately, how damages and legal fees are taxed can be tricky, and this case is no exception. To begin with, the amounts can't easily be netted on a tax return or offset. As a matter of math, Depp gets \$10,350,000 and pays \$2M, so he nets \$8,350,000. That sounds simple, but these will really be separate payments (if they are ever made).

The IRS will likely say that these are separate payments that cannot be netted, giving Depp \$10,350,000 of income, with no deduction for the \$2M. Why no deduction for the \$2M? It's hard to consider Depp's defamation of Heard (which was actually done by Depp's lawyer) as business-related. If a payment is personal—even a big payment to settle a lawsuit—it is not tax deductible.

Heard's tax problems are even bigger. She stands to collect \$2M but must pay \$10,350,000. She has \$2M of income and probably cannot write off *any* part of the \$10,350,000. It seems likely that the IRS would say that she was waging a personal dispute that does not arise out of her business. Business expenses are deductible, personal expenses are not. When Depp pays Heard, is that a business expense?

It's hard to tell, but Depp clearly has a vastly better tax position than Heard.

Depp can argue he sued to protect his business. The IRS could say that this was a personal matter, just one with business repercussions. Heard's case is more clearly personal, and that could make her tax bite especially harsh. Heard will have to pay tax on \$2M, but she may not be able to deduct any part of the \$10,350,000 verdict or her large legal fees.

Both Depp and Heard spent millions in legal fees, although Depp surely spent more, well in excess of \$5 million according to some estimates. But aren't legal fees always deductible? Not hardly. The personal v. business/investment line was always present in taxes, but it is even harsher starting in 2018 when miscellaneous itemized deductions were repealed (until 2026 when they spring back into the law).

In the meantime, some plaintiffs contingent fee lawyers can end up paying tax on 100% of their settlement even though their lawyer collects a 40% contingency off the top. The IRS says you must report the gross amount, and then deduct the legal fees if you qualify. Depp will probably argue that the whole case and legal fees was essential to his business, and he might even be right. Some taxpayers fail on those tax arguments, no matter how compelling.

In a leading tax case from 1963, the U.S. Supreme Court had to decide whether the tax consequences of a lawsuit turned on the origin of the lawsuit (a personal divorce), or on the potential consequences of that suit (Mr. Gilmore's potential loss of his car dealership businesses). The Supreme Court decided that it was the former, making the substantial attorneys' fees paid by Gilmore (which he asserted were deductible because paid to protect his business assets) were nondeductible. See *U.S. v. Gilmore*, 372 U.S. 39 (1963).

Based on this authority, the IRS could say that this case was about Depp's personal life, even if it did have blowback on his career. But whatever happens to Depp's tax returns, Heard's millions of dollars in legal fees don't look deductible. She could try to argue this was a business dispute, but it seems like quite a stretch. Misery loves company, and every year there are thousands of litigants must face big taxes when they resolve a lawsuit. Since 2018, you may have to be creative in looking for ways to deduct legal fees.

Contingent fees don't solve it either. If the lawyer is entitled to 40%, the plaintiff generally will receive only the net recovery after the fees. But under *Commissioner v. Banks*, 543 U.S. 426 (2005), plaintiffs in contingent fee cases must generally include 100% in income, even if the lawyer is paid directly. It's just one of many odd rules on how legal settlements are taxed.

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