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Robert W. Wood
THE TAX LAWYER

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Sue PG&E For Power Shutoffs, Better Think Taxes

No one is a fan of PG&E right now, as Californians face the twin dangers of fires v. blackouts. As PG&E is cutting power *again* to vast numbers of businesses and consumers in what could be the biggest deliberate blackout ever, the bankrupt utility is drawing even more criticism. Despite the protection of the bankruptcy court, could more lawsuits loom? That might make you assume that consumers and businesses could eventually have a payday. If PG&E causes a fire and you lose property or are injured, you may eventually recover. Then you need to know how the IRS taxes fire victims. But what if you just sue PG&E for cutting off your power, causing you inconvenience and emotional distress? Maybe you also lose food from your refrigerator or freezer. If PG&E pays you, is the money taxable?

The IRS says that for settlements to qualify for tax-free treatment, the injuries must be *physical*. Emotional distress is not enough. Even physical symptoms such as insomnia, headaches and stomachaches are normal byproducts of emotional distress, says the IRS. So that means you pay tax. Exactly what injuries are considered *physical* is confusing. If you sue for emotional distress, your damages are taxable. In contrast, if you claim the defendant caused you to become physically sick, those damages should be tax free. Yet, if it is emotional distress that *causes* you to become physically sick, even that physical sickness will not spell tax-free damages. However, if you are physically sick or physically injured, and your sickness or injury produces emotional distress *too*, those emotional distress damages should be tax free. This confusing chicken or egg issue can land people in tax trouble.

Even worse, under the Trump tax law, *you might be taxed on 100%, even if you lose 40% to a contingent fee lawyer!* Some view this bizarre rule as a new tax on lawsuit settlements. Say you settle a suit for intentional infliction of emotional distress for $100,000. Your lawyer keeps 40%, or $40,000. You might think that at most, you would have $60,000 of income to report. Instead, you will have $100,000 of income, even if your lawyer only pays you the net recovery after legal fees. Up until the end of 2017, you could claim a $40,000 tax deduction for your legal fees. But now, many legal fees can't be deducted.

In 2018 and thereafter, with *no* deduction for these legal fees, you collect 60%, but are taxed on 100%. Notably, not all lawyers' fees face this terrible tax treatment. If the lawsuit concerns the plaintiffs' trade or business, the legal fees are a deductible business expense. If your case involves claims against your employer, or certain whistleblower claims, there is *also* an above-the line deduction for legal fees. But elsewhere, you can get no tax deduction at all for the legal fees, unless you are awfully creative. There are sometimes ways to circumvent these attorney fee tax rules, but you'll need sophisticated tax help to do it, and nothing is foolproof.

How legal settlements are taxed post-tax reform is tricky. If your case does not arise out of employment or a trade or business, any taxable money is 100% taxable, even if 40% goes to the lawyer. This no deduction rule is catching many people by surprise. There are sometimes ways to address it, but it requires tax help, preferably before the case settles. There are no easy answers to these problems, but sometimes you can improve on these dire tax results. If you need help, check out 12 ways to deduct legal fees under new tax laws. Settlements are better for taxes and tax planning than judgments. And getting tax advice before a case settles is a good place to start. You don't want to end up like the plaintiff in the $289M Monsanto weedkiller verdict, who may lose 90%.

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.