

## Taxing Elder Abuse Recoveries And Related Legal Fees

By Robert W. Wood



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not intended as legal advice and cannot be relied on for any purpose without the services of a qualified professional.

In this article, Wood discusses the problem of attorney fees when recoveries in elder abuse claims are wholly or partially taxable. He argues that many of these cases can be classified as discrimination suits, allowing plaintiffs to take an above-the-line deduction for the attorney fees under section 62(a)(20).

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The Department of Health and Human Services reports that each year, hundreds of thousands of older people are abused, neglected, or exploited. Elder abuse generally refers to a knowing, intentional, or negligent act by a caregiver or other person that causes harm or serious risk of harm to a vulnerable older adult. Legislatures in all 50 states have passed some form of elder abuse prevention laws.

The laws vary considerably, but abuse can generally be broken down into several categories, including:

- physical abuse, generally involving the infliction of physical pain or injury on a senior;
- sexual abuse, involving nonconsensual sexual contact of any kind;
- neglect, such as failing to provide food, shelter, healthcare, or protection for a vulnerable elder;

- exploitation, involving the illegal taking, misuse, or concealment of funds, property, or assets of a senior for someone else's benefit;
- emotional abuse, including the infliction of mental pain, anguish, or distress on an elder person through humiliation, intimidation, or threats; and
- abandonment, involving the desertion of a vulnerable elder by someone with responsibility for care or custody.

Litigation for elder abuse is occurring more frequently. Given the panoply of applicable laws, it is not surprising that these suits are brought in many different ways. An elder abuse case may involve appalling physical injuries or even wrongful death.

Conversely, an elder abuse claim may involve entirely financial transgressions. Of course, a suit may involve multiple claims — financial, physical, and emotional. For these and other reasons, there is relatively little discussion about the tax consequences of elder abuse claims.

Like other litigants, plaintiffs in elder abuse cases might not consider tax issues until the conclusion of the case or until the following January, when IRS Form 1099 arrives. Some plaintiffs wait even longer, first worrying about taxes as they hover over their Form 1040. Taxes on legal settlements can involve a rude awakening.

Section 104 can certainly play a part in elder abuse cases. After all, recoveries for physical injuries, physical sickness, and emotional distress caused thereby are tax free. There is no reason to think that elder abuse claims should be viewed as a distinct class of cases for purposes of section 104 analysis. A purely financial elder abuse claim is presumably 100 percent taxable.

Conversely, an elder abuse claim may have some taxable and some tax-free damages depending on the facts, claims made, and resolution of the case. Unfortunately, the scope of the section 104 exclusion continues to cause taxpayers, lawyers, and return preparers considerable trouble. The Tax Court is frequently glutted with section 104 cases.

My focus in this article, however, is not on section 104. Although some elder abuse recoveries are 100 percent tax free, many are not. I want to focus on the latter.

### Attorney Fees on Taxable Recoveries

With recoveries that are wholly or partially taxable, how attorney fees are deducted can be a

problem. In *Commissioner v. Banks*,<sup>1</sup> the Supreme Court held that plaintiffs are generally treated as receiving 100 percent of their settlements and judgments. This is true even if their lawyers net the contingent fees and pay their clients only the balance.

In 100 percent tax-free cases, of course, this rule causes no harm. In a \$1 million settlement with a 40 percent contingent fee, if a plaintiff receives \$600,000 tax free, he pays zero tax. So does a plaintiff who is regarded as receiving \$1 million tax free and thereafter paying \$400,000 to his lawyer. But when any part of the recovery is taxed, it is a different story.

The plaintiff will generally be taxed on his net recovery only if the fees can be deducted above the line. In 2004 Congress amended section 62(a) to allow an above-the-line deduction for some legal fees. For the cases covered by the deduction, primarily employment cases and whistleblower claims, the change has been huge.

This provision prevents the often unfair and counterintuitive treatment of the fees as miscellaneous itemized deductions. The 2 percent threshold, phaseouts, and alternative minimum tax can mean that in taxable recoveries not covered by section 62(a)(20), the plaintiff pays tax on the attorney fees. This can even occur in catastrophic injury cases.

If the origin of the case is a catastrophic physical injury or wrongful death, many nontax lawyers and even some tax professionals are lulled into ignoring attorney fees. Yet even in that context, the portion of the recovery that comprises punitive damages or interest remains taxable. To the extent a recovery is taxable, the gross amount is usually taxable, including the legal fees.

The bigger the recovery and the larger the attorney fees and costs, the worse the tax result. With only a miscellaneous itemized deduction, the plaintiff may truly be paying tax on the monies sent to the plaintiff's lawyer. As the Supreme Court noted in *Banks*, there are even situations in which the tax on the gross recovery may exceed the net recovery received by the taxpayer, creating "the perverse result that the plaintiff loses money by winning the suit."<sup>2</sup> The applicability of the above-the-line deduction is therefore important.

### Legal Fees for Elder Abuse

Virtually any claim in the employment setting is covered by the section 62(a)(20) deduction, including whistleblower claims. Beyond those obvious

cases, however, what else qualifies for an above-the-line deduction? What about an elder abuse claim?

Those claims can be brought under federal or state elder abuse statutes. Some are brought as medical malpractice claims. Regardless of how they are brought, some of these cases should give rise to tax-free awards. A mistreated elder plaintiff may have personal physical injuries or physical sickness, along with related emotional distress. But not everyone does, so the elder abuse claim may involve no exclusion.

Elder abuse claims are being added to employment suits, contract claims, rent disputes, and many other garden-variety legal matters. With no physical injuries, physical sickness, or exacerbation of the plaintiff's existing physical sickness, there may be taxation of the attorney fees. Section 62(a)(20) does not explicitly address elder abuse, but there are some indications that it could apply to many elder abuse claims.

### Kinds of Discrimination

A claim of unlawful discrimination is defined to include any claim under "any provision of Federal, State, or local law, or common law claims permitted under Federal, State, or local law . . . providing for the enforcement of civil rights."<sup>3</sup> It is unclear what constitutes a state law providing for the enforcement of civil rights. Structurally, that section is the catchall provision for the definition of a claim of unlawful discrimination.

That may suggest a broad interpretation. The reports for the House, Senate, and conference committees on the American Jobs Creation Act of 2004 (which added the above language) reveal nothing particularly useful. *Black's Law Dictionary* defines civil rights to include "the individual rights of personal liberty guaranteed by [the Constitution], as well as by legislation such as the Voting Rights Act."

This suggests that civil rights can stem from legislative action (and possibly from regulatory action), not just the Constitution and the 14th Amendment. This definition also invites the question of what is a personal liberty. Liberty is defined in *Black's Law Dictionary* to include "a right, privilege, or immunity enjoyed by prescription or by grant."

Personal liberty is "one's freedom to do as one pleases, limited only by the government's right to regulate the public health, safety, and welfare." Protections for the elderly and patients seem to fit within the broader definition of liberty but perhaps not within the more narrow definition of *personal*

<sup>1</sup>543 U.S. 426 (2005).

<sup>2</sup>*Id.* at 438.

<sup>3</sup>Section 62(e)(18)(i).

liberty. Laws protecting the elderly generally establish a right not to be abused or a right to be treated fairly (an egalitarian right).

However, these laws do not seem to establish a freedom to do as one pleases (a libertarian right). The term “unlawful discrimination” (and, by implication, the ambit of the catchall civil rights provision) in section 62 appears to be broad. Specifically included in the definition of unlawful discrimination are violations of some sections of the Americans With Disabilities Act (ADA).<sup>4</sup>

The enumerated sections of the ADA prevent discrimination against the disabled regarding employment, public accommodations, and government services. The ADA is concerned with preventing abuse of the protected class (egalitarianism) rather than allowing its members to do as they please (libertarianism). Notably, the ADA provisions listed in section 62 do not relate solely to employment.

They also cover public accommodations and government services. ADA claims (whether concerning employment, public accommodations, or government services) that give rise to taxable damages are taxable. Yet the attorney fees are deductible above the line under section 62. The same is true for section 1983 civil rights claims.

### Federal Elder Abuse Protections

Under federal law, discrimination against the elderly is generally evaluated under the rational basis test for constitutional review. There is at least one federal law, the Age Discrimination in Employment Act of 1967 (ADEA),<sup>5</sup> that proscribes discrimination against the elderly. Of course, the ADEA is specifically included in the list of qualifying laws in section 62(e).

Unlike the ADA, however, the ADEA may be more easily distinguished from the laws at issue in many elder abuse claims. That is, the ADEA is clearly concerned principally with the employment relationship. Many elder abuse claims in my home state of California are brought under the Elder Abuse and Dependent Adult Civil Protection Act (the Elder Abuse Act).

The Elder Abuse Act was codified in the California Welfare and Institutions Code.<sup>6</sup> The first section of the portion of that code added by the Elder Abuse Act includes statements of legislative intent.<sup>7</sup> Most of those statements are helpful to the argu-

ment that an elder abuse claim is a civil rights claim fitting nicely within the scope of section 62(a)(20). For example:

- “The Legislature recognizes that elders and dependent adults may be subject to abuse, neglect, or abandonment and that this state has a responsibility to protect these persons.”<sup>8</sup>
- “The Legislature further recognizes that a significant portion of these persons have developmental disabilities and that mental and verbal limitations often leave them vulnerable to abuse and incapable of asking for help and protection.”<sup>9</sup> This provision is helpful for drawing an analogy to the ADA, which is specifically identified as a qualifying statute.
- “The Legislature recognizes that most elders and dependent adults who are at the greatest risk of abuse, neglect, or abandonment by the families or caretakers suffer physical impairments and other poor health that place them in a dependent and vulnerable position.”<sup>10</sup>
- “The Legislature further declares that uniform state guidelines, which specify when county adult protection service agencies are to investigate allegations of abuse of elders and dependent adults and the appropriate role of law enforcement is necessary in order to ensure that a minimum level of protection is provided to elders and dependent adults in each county.”<sup>11</sup>
- “The Legislature further finds and declares that infirm elderly persons and dependent adults are a disadvantaged class.”<sup>12</sup>

These statements suggest that the Elder Abuse Act is intended to protect the elderly (a disadvantaged class) from abuse and from violations of their rights. Further, these statements suggest that those rights are often violated because of the physical and mental disabilities frequently suffered by people within this disadvantaged class. In that sense, the Elder Abuse Act can be viewed as a state law enforcing the civil rights of the elderly and disabled.

There appear to be strong parallels between the Elder Abuse Act (and statutes like it) and the federal ADA. Of course, the ADA is explicitly included in section 62(a)(20). That supports the notion that an elder abuse claim should be within the provision, too, perhaps regardless of how it is pleaded. Claims of this sort (brought under the Elder Abuse Act or

<sup>4</sup>42 U.S.C. section 12101 et seq.

<sup>5</sup>P.L. 90-202, codified at 29 U.S.C. sections 621 through 634.

<sup>6</sup>Cal. Welf. & Inst. Code sections 15600 through 15660.

<sup>7</sup>See Cal. Welf. & Inst. Code section 15600.

<sup>8</sup>Cal. Welf. & Inst. Code section 15600(a).

<sup>9</sup>Cal. Welf. & Inst. Code section 15600(c).

<sup>10</sup>Cal. Welf. & Inst. Code section 15600(d).

<sup>11</sup>Cal. Welf. & Inst. Code section 15600(g).

<sup>12</sup>Cal. Welf. & Inst. Code section 15600(h).

similar laws) should arguably be viewed as claims brought under state law providing for the enforcement of civil rights.

### Patients' Bill of Rights

Some elder abuse claims are also brought under patients' rights laws. This is another fruitful inquiry when it comes to attorney fees. For example, there are many California regulations concerning patients and nursing homes.

A complaint alleging elder abuse might refer to the Patients' Bill of Rights, a part of California's Code of Regulations.<sup>13</sup> Among the rights listed are:

- the right to refuse medical treatment;
- the right to be free from discrimination based on sex, race, color, religion, ancestry, national origin, sexual orientation, disability, medical condition, or marital status;
- the right to meet with others and participate in activities of social, religious, and community groups; and
- the right to be allowed privacy for visits.

These rights arguably invoke classic constitutional civil rights, such as religious freedom, free association, nondiscrimination, and privacy. There is also a provision that appears to require due process for the denial of these rights. It allows the denial of the rights only if authorized by law, and it requires the denial or limitation of the rights to be documented in the patient's health records.

In California, other elder abuse claims may allege violations of Cal. Code Reg., tit. 22, section 87468. This section, titled "Personal Rights," applies specifically to residential care facilities for the elderly. It too contains civil-rights-sounding protections.

For example, these provisions include the rights to religious freedom, to vote, and to be free from "corporal or unusual punishment." An elder abuse complaint may also allege violations of Cal. Code Reg., tit. 22, section 87467. That section does not contain overtly civil-rights-related provisions.

However, it generally ensures that a resident in a California residential care facility will have the ability to participate in decision-making. One is reminded of the privacy to make medical decisions regarding one's own body, as in *Roe v. Wade*.<sup>14</sup> For these types of claims, too, therefore, there are arguments that those provisions are state laws enforcing civil rights.

<sup>13</sup>Cal. Code Regs., tit. 22, section 72527.

<sup>14</sup>410 U.S. 113 (1973).

### Allocating Fees

One can reasonably argue that a taxpayer with legal fees for pursuing elder abuse claims should be entitled to an above-the-line legal fee deduction. Apart from the other points enumerated here, there is the general notion that the IRS and the courts appear to be construing above-the-line legal fee deductions liberally. This suggests that a successful (and taxable) elder abuse claim should be taxed like a successful (and taxable) employment claim as far as legal fees are concerned.

Of course, there are still many legal claims that fall entirely outside the scope of the above-the-line deduction. Examples include claims for defamation, claims of infliction of emotional distress, contract disputes, and property disputes. Unless those claims are made in the context of employment or involve civil rights, the legal fees can generally be deducted only as miscellaneous itemized deductions.

But if civil rights or employment claims are part of the case, the IRS and the courts seem to approve all the fees as an above-the-line deduction. That is, the IRS has not pushed to divide the legal fees and to allocate them based on which claims truly relate to employment or civil rights and which do not. That stands as a welcome contrast to some other areas in which legal fees are divided and treated as nondeductible, deductible, or subject to capitalization.

### Conclusion

With the aging of America and the expansion of laws designed to protect the elderly, elder law has emerged as an important legal specialty. Elder abuse claims are burgeoning, and it is only a matter of time before the tax laws catch up. Perhaps because of the very name "elder abuse," some plaintiffs, their counsel, and their tax advisers are making aggressive use of the section 104 exclusion.

Yet there is no suggestion that the IRS will view elder abuse claims differently from the other myriad contexts in which damages are awarded. Regardless of the identity of the plaintiff and the way in which the case is pleaded, what is paid "on account of" personal physical injuries and physical sickness will continue to be examined as it has been. Moreover, when recoveries are wholly or partially taxable — as some clearly are — the tax treatment of the contingent attorney fees is an issue waiting to be addressed.