AFG | SETTLEMENT PLANNING

Punitive Damage Double Tax Trap

As a dedicated plaintiff's attorney, it's crucial to secure the best possible outcome for your clients when it comes to their award. Unfortunately, in cases involving taxable damages, clients often find themselves facing the burden of taxes on both their received award amount and the attorney's fee. However, there are innovative tax planning strategies available that can effectively double or even triple the post-tax settlement amount for your clients.

Comprehending Taxable Damages

While settlements for personal physical injuries without punitive damages or post-judgment interest are typically tax-exempt, the majority of other legal recoveries are subject to taxation. These encompass a wide range of cases, including employment law, defamation, libel, emotional distress claims without physical injury, fraud, breach of contract, and professional malpractice suits.

The Plaintiff's Punitive Damages Double Tax Challenges

In a significant twist of tax law that occurred in 2017, plaintiffs now face the obligation to pay taxes on both the award they receive and the attorney's fee portion of all punitive damages. For example, in a verdict that awarded $10 million punitive damages with $4 million attorney's fee, the plaintiff is liable for taxes on the entire $10 million, even though their actual share is only $6 million. This creates a substantial financial burden for plaintiffs and minimizes their reward.

The McDonalds Case

The most famous personal injury verdict in America is arguably Liebeck v. McDonald's. This lawsuit was so famous that it was the subject of a documentary, mentioned by Toby Keith in a country song, and spoofed on an episode of Seinfeld. Most people only remember a jury awarding Stella Liebeck $3 Million dollars for burns caused from hot coffee. What the jury actually awarded was $160,000 for her compensatory damages (medical bills and pain and suffering) and $2.7 Million in punitive damages (decided by the jury because it amounted to about two days of revenue for McDonald's coffee sales.)

In this case, Stella was awarded $2,860,000 in total by the jury. Her attorney would receive $1,144,000 in fees. As far as her tax liability, Stella Liebeck would not owe taxes on the compensatory damages in the amount of $160,000, but she would owe approximately $1,350,000 in taxes on the $2.7 Million dollars of punitive damages. In this scenario, Liebeck would have only netted $366,000 minus any type of costs associated with her lawsuit.

Contact us today to discuss our innovative tax strategies to maximize your net payout.

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Strategic Tax Planning to Minimize Tax Liability and Maximize Award

The encouraging news is that innovative tax planning strategies exist to drastically reduce the tax obligations of plaintiffs. By collaborating with an experienced settlement planner like Brian Adair, plaintiffs can explore these tailored strategies, significantly reducing the tax burden on their verdicts.

In Liebeck v. McDonald's, AFG could have possibly saved Liebeck the taxes on the attorney fee portion of the punitive damages, which in this case could have been as much as $510,000, thus taking her settlement from $366,000 to $876,000.

For attorneys anticipating taxable punitive damages in an upcoming case, it is imperative to consult with a skilled settlement planner to minimize your client's tax liability. To explore tax planning strategies customized to your specific case, contact us today for a free consultation. If you have already received a verdict that awarded punitive damages, but you have not received a payout, there is still time to plan.