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SUMMARY KEYWORDS

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Good morning. My name is Ed Laden. I'm an attorney. I practice here in Washington, DC. And in Maryland, I have 30 years of experience in litigation. And as a tax lawyer, I've focused my practice primarily on corporate defense defending companies and employers. But I also do a fair amount of work for plaintiffs. And I also do white collar criminal defense for companies and for individuals. And the course of my practice, I have developed a specialty in assisting lawyers who are in the midst of settling employment cases. Part of my my credentialing is I am the current chair, and was the past year as well, the American Bar Association section of tax committee on employment taxes. And so I've, I do a foot in all worlds, or at least both worlds. And so I've developed professional expertise in this sort of arcane art, of being able to resolve the tax issues, and to plan for the tax issues that are predominant in employment cases. One of and truthfully, this is something that has come from hard experience, and from a real need among the bar for good advice, and for education. And navigating what, at first glance, appears to be very difficult issues, but blessedly with good advice, and with some good planning, actually can turn out to be fairly straightforward, and addressable, and for which there are pretty good, hard rules, hard in the sense that they can be relied upon black letter law, and safe harbors. So without further ado, let me move into our slide presentation, you should have been provided with a copy of these slides. And so what I will do is, as we're looking at a particular slide and discussing it tell you that so I would add this mode, that's this juncture asked you to move over to slide number two. And one of the issues one of the fundamental issues that many folks run into are social security disability income. Sometimes it arises in the realm of litigating to help someone who is disabled to obtain Social Security benefits. Other times that it arises in the context of someone settling an employment case, for someone who is on SSDI, or a tort for someone who's an SSDI, someone who may have had a medical malpractice event or been an auto accident through this sort of thing. And the question arises, well, our Social Security disability benefits taxable, and more to the point, if I earn additional income, is there a threshold above which I put in jeopardy the non

taxability of my social security disability income? And the answer is that first, as a practical matter, SSD benefits are free from federal income tax under certain conditions. And basically, they boil down to if half of the SSDI income plus all other income, all taken together is less than $25,000. For a person who's single or $32,000, or someone who's married filing jointly. As a corollary up to 85% of these benefits are taxable, if half of the SSDI plus all other income is more than $34,000 for a single person and 44,000 if that person is married and filing jointly. So, you and essence, you have a situation that even in the worst case scenario, in worst case being a punch of income, a supplement of income from settlement of a case or by some other means even other employment, up to 15% of the SSDI income will still remain tax free. One little corollary one little point of caution here,

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all the benefits would be subject to federal income tax, if someone is filing as being married and filing and filing jointly, but really are not living together. That's sort of considered to be gaming the system and you run into the teeth of the Internal Revenue Code and so this punitive measure of making All of the benefits taxable comes into play at that instance. Moving on to slide three sort of related issue that we run into, are not social security disability, but disability payments, that result from someone who has had disability insurance for which premiums were paid, and is now invoking the protection of the Disability Insurance and Internal Revenue Code Section 106 addresses this directly. And the car the test really boyens burns, that boils down to whether the plan was provided by an employer, and who paid the premiums for that disability insurance. And we break out the different scenarios here. If the employer pays if the employee, the recipient of the of the disability payments, pays premiums with after tax dollars, then the disability benefits are tax free to the employee. So in other words, you get paid, you have wages, you pay tax on those wages, you use that wage income to pay these benefits or pay these premiums, then the benefits you receive are tax free to you. If you pay the premiums, however, with pre tax dollars, under some sort of cafeteria plan or other plan that your employer may have established, then the portion of the benefits attributable to those pre tax payments are tax well. In other words, you may have had periods when you use after tax dollars, and to pay premiums and periods when you used pre pre tax dollars to pay premiums, we then would have to proportion and allocate what portion of the benefits are subject to tax at that point. Now, if your employer is very generous and pays some or all of the premiums, then the portion of the benefit that you receive that's attributable to the employees share the premiums is subject to tax. And again, we look at the at what portion of the premiums were paid with something other than pre tax or employer dollars. In other words, after tax dollars, and what were paid by for premiums were paid with with pre tax or employer dollars. Brett making that split helps us determine what portion of the benefits are tax free and

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what are taxable. Very important point here is how ever you pay the premiums This is as an employee, those premiums are not deductible as a medical expense. I the one caveat here is that for an employer, of course, they may well be with for the employee, they are not taxable under most circumstances. Moving on to slide four. And here we strike the discussion of Internal Revenue Code Section 104104 is probably the most invoked, it's certainly one of the most understood and the most misunderstood sections of the Internal Revenue Code. And really the the section the Internal Revenue Code, which the most number of lawyers are familiar with, because it arises in the one of the areas where many of us practice and that is personal injury law in either prosecuting or defending tort, and section 104, a two which has been amended over the years. But under its current guise, provides that all recoveries and this language is very, very important to take into account. So all recoveries on account of physical injuries or sickness, very, very important. landmark, their physical injuries or sickness are excludable from gross income, including lost wages, emotional distress and attorneys fees, and under Section 2010 or under 2010 regulations which as a matter of background, I worked on and testified before the Congress and before the Internal Revenue Service in relation to the language that's been changes there does not have to be a tort or tort like cause of action. So in other words, where do we this command? Well, the classic example that we always run into as as common of kind of claims, as anyone will ever see is a motor tour. Somebody is in an auto accident, or somebody slips and falls where somebody has a medical malpractice recovery. In those cases, every single dollar recovered, is tax free. It's just the nature of the beast, so long as it involves physical injuries or physical sickness, which by the nature of the kinds of cause of action we just mentioned, are the essence of the cases somebody got hurt, they have medical bills, and they have medical pain. And that covers the waterfront. Now, just as sort of a background, I mentioned the 2010 regulations, and the removal of the requirement for a tort or tort law cause of action. The reason for that was just as background is several states, New Jersey being one of them, I'm familiar with the with the New Jersey provision, they have no fault provisions. In other words, these are not torts. These are statutory causes of action. And the the claim is one under statute, not as a tort. But simply as you can show a certain set of facts and you're entitled to compensation. There was a concern that these kinds of causes of action by not being a tort per se, but being statutory, and frankly, by contract, in other words, you buy a policy of insurance, and that's really all you have to do. That being so they could have fallen outside the ambit of one for a to given its strict language. These regulations make it clear that that's not the case. And so if you practice in a jurisdiction that has no fault types of policies, of course, everyone voted toward that you defend or which you prosecute, will be eligible for treatment under Section 104 H O. As a corollary to this, as well as as an analogy, section 104, a one provides the same kind of treatment for amounts received under workman's compensation acts. And those also are excluded for income. And this includes even if the compensation for workers comp is for emotional distress.

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And that could be simply the entire cause of action, someone on the job had an event that caused them emotional distress, without physical injury. This and we're going to talk about the the the impact of wonderful, and employment cases, strict my employment cases. But here we have a carve out that could be significant if you have a client in an employment setting, who qualifies for workers comp because of events that happened on the job, which could include abusive conduct if something is crafted that way. In that case, emotional distress damages are non taxable, and is distinct from applying 104 a two, which requires physical injury or physical sickness. So there is a possibility here of being able to, with some grace and strategy be able to plan a cause of action, that provide non tax treatment for recovery that might not otherwise appear to be the case in the employment setting. And we'll talk much more about employment as we move forward here. Moving on, however, to slide five, and we're going to talk about employment games. For the most part. Employment recoveries are includable in income, but it the characterization of that income may be different. And the distinction really being the most important one is is something ordinary income, or is it wages, for example, we mentioned emotional distress damages a moment ago and other non physical injuries. Generally speaking, those are includable in income. We call them non pecuniary damages, but they're not wages. And that's a very, very important distinction, which we'll really go into in a few minutes. Along these lines, associated attorneys fees are includable in income as well and have been since 1996, at least. However, there is a good app for that there is there is a safe harbor for that, and we'll talk about this more as well and that those fees, which are includable in income are also deductible on $1 for dollar basis above the line pursuant to Internal Revenue Code, Internal Revenue Code Section 62 a dash 20 if claim is brought to remedy unlawful discrimination or its work on behalf of the government under a key Tom or a False Claims Act type of scenario or as a whistleblower claim under governmental issues, or its otherwise statute specified under Section 62. A, as being brought to remedy unlawful discrimination, as we'll talk about unlawful discrimination is defined extremely broadly under Section 162. A. And so this is something to take into account and we'll talk about these as to how you can revoke section 62, a 20. And section 62. A, and you'll see that it's very straightforward. I mentioned a moment ago that the include ability of attorneys fees and income which actually dates back to 2005, as the seminal case, the commissioner versus banks and Supreme Court told us that as a general rule, when a litigants recovery constitutes income, the litigants income includes a portion of the covering recovery paid to the attorney as a contingent fake. And that has been extended to include settlements, whereby employers agree to pay the claimant, former employer, perhaps current employee, depending on the terms of the settlement, that that that person's attorneys fees, which may or may not be specify those in scenarios where the employer agrees as part of a settlement to play pay those claims. Those are also includable. In income, that is the attorneys fees, but also deductible, as I mentioned a moment ago under Section 62, a 20. Just as a sideline, Max, the Supreme Court, at that point, the client to address what happens when attorney fees are paid by the defendant pursuant to a fee shifting statute. However, as a practical matter, it's been assumed by almost everyone who

practices in his area, that those attorneys fees that would be statutorily provided for under fees as fee shifting, for example, they after LSA, or some other federal provision, on title seven, for example, invoking section 1988, or even in a 1983 case, where section 1988 may come into play. Where attorneys fees are awarded NASA scenario, it's almost always

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concluded, we all agree that they're included one income. And one of the reasons why what why there's not a big fight about that is because we have the benefit of Section 62 a 20. Where those attorneys fees if everything is done properly, and it's not that hard to do it properly, are excludable from income or at least deductible from bubble II, with the same result that they net out 00. Moving to slide six, there are scenarios where the amount received is includable in income as wages again, this is a very, very important distinction. Now between ordinary income and wages, and the reason is ordinary income is includable in the income of the recipient, of course, but the IRS doesn't collect that until the employer files the federal income tax the year after they receive the money January, for example, if somebody has a settlement here in 2020, well, they're not going to be doing this tax until they file the federal income tax return sometime around April 15 of 2021. And the IRS will know that they owe the money because as we'll discuss in a little more detail, the IRS will will have received a form 1099. And that's how they link things up if they see a 1099 with a large dollar amount. And that large dollar amount doesn't appear on the recipients federal income tax return for that year. The IRS is going to ask why not? Where Where did this money come from? So that's ordinary income wages, by contrast, are treated a little bit differently. First of all, they're subject the federal income tax withholding, and we'll talk momentarily about the amounts generally in most cases 22% but that could vary. But if that's what withheld, they also are subject to fica, the 6.2% oasdi. Tax, that is the old days, we call that the hospital or the Social Security tax. That's what funds Social Security. And that's on the wage base amount for 2004 2020. That's 137,800. In 2021, I believe that goes up to 142,500. So anything over and above that wage base amount, is not subject to the OSL oasdi. tax is 6.2%, which, by the way, applies on both the employer side, and the employer Isa, both sides, pay 6.2%. And on top of that, we have the 1.45% Hospital tax, the Medicare tax, that's what funds Medicare, and that's on the total amount, there is no wage base limitation as respect to the hospital tax. So as I say, that is applied separately against both the employer and the employee II. And just as a as an example of what happens in a scenario where there, someone's an independent contractor in that case, while they get that the independent contractor gets to pay both halves. And so they're paying what's called a seek attack, self employment tax. That is 13.65%. So you know, are 13 points were 15.3%. So, again, 6.2 plus 1.45, times two, so adding up to 15.3%. So that has a significant bearing. By the way, we also would have the federal unemployment tax the food attacks, as we call it, and that 6.2% of the first $7,000, but that's payable only by the employer. Moving on to slide seven. And here we get into the situation where there is some kind of controversy as to how an amount ought to be treated. One can refer to technical advice memorandum 2002 44 004, tam 2004 2000 to 44

04, which will describe for you the rationale used by the government, which boils down to that the government looks to, for example, a settlement agreement, and really tries to discern what is the nature of the claim,

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whatever, even if the claim, as brought was not valid. In other words, it didn't succeed as such, but was brought as such. They asked us what were the damages paid for, and the IRS will allocate. It's a lump sum payment, using the best evidence available. And of course, they're going to look at the plaintiffs complaint and all the claimants, written materials, and look for what would be a reasonable amount of damages for each of the claims. And with the starting point, bam, is this the type of claim which is eligible for non tax treatment under Section 104? Hmm. And again, as we know, section 104, a two is the best treatment one can get, because it provides for tax free treatment, without having to worry about something is ordinary income, or it is wages, or any other these categorizations. So it really all depends on the nature of the claim, which, and then you hear me say this many times during the course of this presentation, is why it is so important to think about these issues at the beginning of a claim and at the beginning of your representation at the beginning of your communication with the other side. And that's true, whether you're bringing the claim or defending the claim, that record you make is what the IRS is going to look at, in making a determination as to the nature of the claim, and hence the tax consequences of the claim. Moving on to slide eight, if you for example, make an allocation in a agreement, which may agreements do, generally speaking, the allocation at that point is if it's a if it's a kind of tort, or if it's or if it's a kind of claim to which one or for a two applies, it'll say so in the settlement agreement, both sides will agree that this is a claim bro For physical injuries or sickness, and hence ought to be brought under Section 104 a two, which by the way, if that's the case, also obviates, by instruction from the IRS, the pay ORS, the defendant or the employer as the case may be their obligation to issue a form 1099 at all. In other words, the IRS CEP tells us specifically, if a payment is made pursuant to Section 104, a two or two which are another way to which 104 a two applies, then in that instance, there is no obligation on the part of an employer to issue 104 a two or on any other or to issue a form 1099 under any circumstance. And that's a very important distinction. What the IRS does exactly the facts and circumstances indicate that the allocation reflects the true economic substance of the settlement. So here's the big key there. It looks to several things. One, is this a physical injury or physical sickness claim? Having let's assume that that's something that's that the IRS rejects or never is brought in such a fashion that the parties just decide this is not something that involves physical injury or physical things or simply can't reach agreement, that the claim involves physical injuries or physical sickness? What's the determination? And well, the determination then, is what portion of the payment is income, ordinary income and not subject to fica? futa? Or, and how much is wages? And in doing that, the government is going to look towards what's the economic reality. And here's, here's how we draw the line on that

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5050,

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we're always almost always be a safe harbor. So in other words, if you're making the decision, and we're negotiating with the other side, if you represent the employee or the employer, as to what portion of this payment that we're, we're negotiating should be wages, how much should be ordinary income, you do a 5050, you're probably fine. If you want to move off of that. And and and have it be some other amount, some other proportion? Well, some factors come into play. For example, if you have someone who is an investment banker, making a base salary of $100,000 a year, and she brings a claim for sexual harassment, or some other sort of claim, that cost her her job, well, it would end she does not get a new job right away. So you do have a claim for for front wages and Pac wages. At that point, if you try to make a distinction, you say I'm going to settle this million dollar claim for a million dollars. And I don't want to allocate 750,000 of that to emotional distress damages, and $250,000 on it to wages. Well, the IRS is going to look at that a little bit skeptically for the simple reason that if this is someone who is not reemployed, and is looking at having front and back wages for a year's worth of time, well, that $250,000 is much less than the income, that person the wages that person would would earn over the course of a year. And the IRS is gonna say this really doesn't reflect the economic substance. And so this 7525 split to emotional distress damages may run wherever very well not satisfy the smell test. By the same token if you have someone who's employed as a maintenance worker, and they are very subject to horrible discrimination, and horrible conduct, on the part of supervisors, so the nature we don't need to go into in terms of the types of things that can happen in the workplace, but you can just imagine, racial slurs are other indicia of racial hate and discrimination. And someone makes $35,000 a year and is constructively discharged is subject to this kind of behavior so badly that they have no choice but to leave their job and are not employable. One night instance, the same settlement for $1 million And splitting the the proportion to 90% to emotional distress damages and 10% plus wages makes perfect sense, because that's someone whose wages would not add up even over the course of several years, to the 100,000. And the the extent the the nature of the harm that they were, that was inflicted upon them, the emotional toil that on its face justifies a very high emotional distress damages claim. So that being so that is really requires a sensitivity to the types of causes of causes of action, and the real knowledge and of the economics of the climate, in terms of wages, in terms of their ability to be reemployed again, and in terms of the the time that it takes for them to find a new job, if they ever could find a new job, that's equivalent to the one that they're leaving. And so this boils down to a requirement to establish the potential the universe of potential claims early in your negotiation process, and then negotiate against that backdrop, in a way that accounts for the ultimate allocation of the settlement amount. Or in other words, as is almost always the case, in any kind of litigation, you have to know what your next move is, and where you're going to end up if you make that move.

It's classic litigation, but one that is extremely vital in this settings.

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Slide nine is a repoint you to a document that I know many Employment Lawyers look to. And that is an IRS internal document that it uses in determining the income employment tax consequences and appropriate reporting of employment related judgments or settlements, when it's the IRS, or the Treasury Department, or any other governmental agency, who is the the defendant as an employer, in other words, the government, IRS as an employer, this was actually issued several years ago in 2008, by john Richards, who was then he and the Office of division council chose associate Chief Counsel. I've known john professionally, and he's presented for my committee in the ABA. And he's wonderfully competent, and very, very erudite lawyer, and he wrote this, this document very well. And you could, I think, rely upon it as sort of background for the IRS his position on these things, and as a treatise, in some measure, at least in a nutshell, of these areas of the law. So I would highly recommend that you get your hands on it. If you can't, I'm leaving my, my email and phone number at the end of this presentation. And you can feel free to reach out to me and I will get you a copy. We talked about the distinction between wages, and ordinary income, and section 104. A to where, which, which, which provides no taxability. But let's, as we move into slide 10, look at a scenario where we know we have wages, and we run into the situation as to what's wages, we know it's subject to the three factors that I mentioned earlier or two factors. So have you break it one being that it's subject to federal income tax withholding, excuse me. And we also know that it's subject to fica, which is itself to fall, the oasdi tax, the 6.2% tax, and the 1.45%, Medicare tax, the old hospital tax. So we know something is wages, it's subject to federal income tax withholding. And so the question that then that then is presented to us is, how does an employer withhold? In other words where this will come up? Is the employer withholding too much? That's always where you get that question. And, as a practical matter as a matter of law, actually, lump sum payment is generally characterized as being supplemental wages, which is a term of art for these purposes, because the federal income tax rate, putting another way the rate of palm which federal income taxes are withheld on supplemental wages, again as a term of art, is one that the employer may choose to withhold and a flat 22% rate or separately, adding the supplement the wage payment to concurrently paid wages, and withhold using the usual method taken into account. And the exemption on the employers recipients, the employees, actual IRS Form W four. In other words, treat the supplemental wages and treat the settlement amount, as if this is just a bonus or something payable to the employee, ie as part of their regular payroll period wages. And we'll hold on that amount. To do that, though, and that may or may not turn out to be more advantageous to the employee or not. And by the way, the employer always has the option of withholding it the flat 22% rate under most circumstances. And it could be a matter of negotiation, it can't be the second method, the one where you just employer in any way just includes this, this amount as payroll that is not available if the employer did not withhold income tax for the recipients regular wages in the current or immediately

preceding calendar year. At that point, the employer must obtain a Form W four and take the claim exemptions and northcap. That's become less important, frankly, since the enactment of the take the the tax cut and

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jobs creation act, and excuse me, 19 and 2017. Because with the at least temporary repeal of the personal exemption, the value of the personal exemption has basically gone away and thus the requirement to be able to name your personal exemptions on a Form W four has gone away. I always tell the story. When I was with a big firm, we were presented with the issue of an executive for a technology company who hadn't received a very large option package and was executing on that option pack package and was receiving a multi million dollar payout and who wanted to minimize their their tax obligations on us, and who decided on advice of counsel to file a revised Form W four. And that would include additional withholding amounts where we provide different additional personal exemption amounts, which result in less income tax being withheld. In this instance, the executive claim 37,000 exemptions, and not surprisingly, this raised some eyebrows within the firm and within the offices of the IRS. And so I would just say without going into too much detail, that that would not be an advisable course of action. In this instance, the value of that actually would be somewhat minimized. But we we move forward with with a little bit more wisdom, hopefully now, by the way, I've mentioned in almost all instances, the two choices of the 22% or the included the inclusion of that income, that those that lump sum in a regular payroll. The exception is by regulation 31 point 3402 g dash one a two, which mandates withholding at the highest applicable rate for any portion of a lump sum payment that exceeds a million dollars, you should be so lucky to get a million dollar payment. If you do and the amount that exceeds a million is going to be withheld at the top personal income rate, which was 39.6 is now 36 is probably going to go back to 39.6 or at least is slated to after the the end of the suspension period that was put in place under the tax cuts and JOBS Act. So that's just as a as background, sort of the three scenarios that you could face on withholding. One of the things moving to slide 11 One of the things we talked about earlier was section 62 and specifically section 62 h1 as a general rule, unless a case involves section 104 a two and it does involve Have an employee a situation. And almost all of those instances, the income, that or the the income of the recipient will include any amount of the attorney's fees in that, even in a contingency fee situation comes into play. Lastly, and a guy said, especially because prior to the enactment of Section 62, a 20, and 2004, this was a major problem for employee employment litigation, people would be recipients of very substantial settlement amounts and hundreds of 1000s of dollars. And they would be subject to both the the ceiling and the floor on the deduction of miscellaneous itemized deductions. And the alternative minimum tax, which would in many instances actually result in a net negative consequence. In other words, a person could be paid hundreds of 1000s of dollars for very real, and horrible discrimination or abuse in the workplace, and find themselves having to pay out Uncle Sam being in a worse position than they started out.

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And the enactment of Section 62, a 20, was specifically meant to address that situation. And under Section 62, a 20. attorneys fees for unlawful discrimination cases are deductible above the line. In other words, they're includable in income. But they can be they're reported above the line. And we'll talk in a moment as to how that happens. And what they're immediately deductible above the line as well. So from a nerdy tax point of view, what it means is the adjusted gross income amount from which we derive taxable income doesn't include this. So in other words, it's the if the net effect is it is as if those attorneys fees were not includable in income. And that's a very good outcome. As I say, these are generally includable, even if to continue even as a contingency fee, or paid by the respondent to the company. As I mentioned, section 62, he defines unlawful discrimination very, very broadly. It includes everything. And by the way, I should mention, it's 18 subparts. It includes almost every federal cause of action that one could think of that addresses civil rights issues, section 1983, of course, title seven, of course, all of the remedial federal statutes, under the flydsa, and the ADA and the ADA, all of these, of course, which would seem to make sense, every state corollary every state analog to those federal cause of action, is also included. whistleblower claims are includable. And most specifically, section 62. We 18 i, m, is one and includes any provision of federal or state law or common law for the enforcement of civil rights. In other words, even if it's a kind of cause of action, that's not enumerated in the first 17 of the subsections of Section 62. A five involves enforcement of civil rights, it is in fact, eligible for Section 62 a 20 treatment. And, and really the, the the most important subsection is section 62, age 62 e 18. Paragraph two, that covers such laws regulating any aspect of the employment relationship. In other words, if any portion of the cause of action is as a result of or in connection with an employment relationship, and 60 section 62 a 20 applies and that's a very good outcome. I mentioned that we will teach you how to do this and this I will trust is a question that comes up all the time in my own practice and I know that it's one that befuddles attorneys and most certainly befuddles clients who are always concerned, how do I get this benefit, and if they do it, according to the IRS, and your publication 525 taxable and non taxable income, the latest version being the revision, published in February 2020. On page 30, the IRS instructs us to deduct the attorney's fees that qualify for Section 62, a 21, line 22 and the IRS Form 1040. And that's the schedule one, as you know, the IRS revised section 1040, a year or so ago. And we now have these different schedules in which to include the deductions and this sort of thing, the first page of the 1040 really being more or less an information return right now.

46:02

Excuse me, and putting forth the the basic information. So one that schedule one on line 22 of the form 1040. You report the attorneys fees. Now, what about the other pros, what about the net by the way as a deduction as a corollary, the attorneys fees themselves along with any other non pecuniary proceeds are reported on line eight. So in other words, we had someone who had both attorneys fees, and of course, emotional distress or other kind of non pecuniary damages. That

entire amount, let's say it's $25,000 of attorneys fees and $75,000 of non pecuniary and it's genuinely emotional distress damages. That entire $100,000 is reporter online, Kate, the 22,000 or the 25,000 of attorney fees in term are reported on line 22. They offset each other. So in other words, line 22 offsets line eight. The net amount of attorneys fees thus is zeroed out. I use as a mnemonic, I'm an old football fan, and I use a modern Troy Aikman throws the ball over the middle to Emmitt Smith. You all guys will recognize the numbers worn by those players, but Troy Aikman wore number eight Emmitt Smith or number 22. And so if that helps you remember where to put these things line a line 22 Troy Aikman over the metal to Emmitt Smith. Hopefully that makes things a little easier and and can help you to come down and help clients navigate through this very scary, but actually fairly straightforward area. We mentioned earlier in the presentation forms 1099. And forms 1099 are really the basic means for communicating with the IRS. And this sentence is probably the most important form. And it's how the IRS knows the only way oftentimes, the IRS will know that a payment was made. In an employment case, no w two was issued except for the mountain subject or that's characterized as wages. And oftentimes without a form 1099 being issued, the only way the IRS would know about a payment and this happens to is if there's an examination conducted of the employer. And one of the areas examined by the the revenue agent will be the company's experience in settling employment disputes. And it has happened that a settlement that the IRS was unaware of will become known to the IRS by conducting this audit. And if there is still time under the applicable statute of limitation, which is generally three years the IRS will not be shy about reaching out to the recipient and saying hey, by the way, he didn't declare this on your your your income tax for the year in question. Um, what about it? And taxpayers gonna be in that instance in a situation of having to make some good explanation and probably pay additional tax and probably, at least have the IRS assert the negligence if not a fraud penalty. Just something about which to be aware, in most instances, though the IRS is aware of these this a payment of a settlement, because the employer will issue a form 1099 Miss M is sick.

50:17

Just as point of background. a year or so ago, the IRS changed slightly. Its 1099 system up before 2020. Everything was reported on a 1099 mess and all kinds of income. In 2012, the IRS issued a form 1099 n e c, we don't talk about here, but a form 1099 any C is for non employment payments. In other words, it's not employment compensation to me to be perfectly precise, those are payments made to independent contractors. And so in a situation where someone performed services, they were an independent contractor. The employer reports those payments on on the any say the not any say before without getting too much detail. They were reporting in box seven of the 10 night that I missed, and you may even see some employers some service recipients still doing that, or they shouldn't they should be using new form. But that's the distinction. So under under the new IRS 1099 miss the one that should be in use. Now. All payments to the client are reported in box three. And that includes both the attorney's fees portion, and any non pecuniary

compensation, the emotional distress amounts, everything. In other words, that's not a wage payment. That gets reported on box three. Now the payments to the attorney are reported in box 10. In other words, with just a good explanation complete here, the client, it's always going to be box three o amounts, there used to be under the old regime under 1099 s a box 14. Now, what used to report it on box 14 is now reported in box 10. And these are amounts paid to an attorney. So one employer is going to issue to settle your case to 1099 misses one to the employer, he or the former employee who's now climate and one to the attorney for the imbalance of the attorneys fees. Now, very, very importantly, these are inbox 10. And the reason that's important is box 10 tells the IRS that while these are amounts that are by law, reportable to any attorney for any for any reason other than the attorney is actually your lawyer performing services for you. That's when we get into that box. The 1099 96. In essence, payments are made to a lawyer by statute. They are they must be reported on a 1099 mess in this instance, is box 10. If you IRS knows that an employer who's or a lawyer who settled a case with an employer for let's say, $575,000. They know if that $575,000 amount is reported on box 10 that the lawyer isn't getting to keep all that money. That's not income to the lawyer. That's not compensation to the lawyer for services the lawyer performed. What it is, is mounts paid to the lawyer in order to settle a case. And that portion of that may be attorneys fees set forth in the settlement payable to the lawyer. It may be the entire amount and the lawyer is under a contingency fee arrangement where the lawyer gets to keep some of that money. But the bulk of it or at least the larger portion of it goes to the client doesn't matter. The IRS knows that the the attorney the law firm isn't getting $575,000 of income here and won't expect to be paid or one expect that to be paid tax that entire $575,000. The problem we would run into in earlier cases is under the the old regime under the 10 nine that I miss. Sometimes the payments to attorneys fees were reported on box seven. Sometimes the payments to the client for the former or current employee report in a box seven, box seven and Nat instance told the IRS that this is income to the recipient, and thus to expects some sort of, of tax to be paid on. And and then not only that self employment tax to be paid on it because the was for the performance of services, which subjects the recipient, the self employment tax. Now, that's all done on the 1099. Any See, long and short way of saying it is, in these scenarios, we should never be looking at a 1099 NTC, we should always be looking on a 1099, Miss, and box three, and box 10. That should be the universe of information reporting in these instances, anything beyond that we're going to be raising problems for the IRS. And we're raising problems specifically for both parties, the attorney and the client and for the employer. Because what we'll talk about earlier, there are consequences for filing incorrect information returns, especially an employment context.

56:13

Moving forward to box 14, um, question often arises, especially in large settlement amounts, boy, I'm going to pay an awful lot of tax on this. Is there any way we can spread this out over a couple years? You know, I know that people do that all the time, right. And so a client will say, of course,

my brother settled a case when he went when he was in an auto accident, and they paid it out over a couple of years. Why can't we do this in employment cases? And the short answer is, while it's difficult to do on an employment case, it's not impossible. And the guidance for doing this is under private letter ruling 2008 30 6019 2008 36019, which provides for the deferral of federal taxation through periodic payments to claimants that are expressly spelled out in a settlement agreement. This is by the way, not something that is not complex. It is very complex, and very, very formalistic. And you got to really lay this out at the beginning of a case, or at least the sub beginning of a settlement the case, and choreograph what you do to match this outcome. The key factor here is the obligation to make the periodic payments are subject to a non qualified assignment to a third party, which funds an annuity, usually these annuities are off shore. Why is this important? Why is it why what is this business about a non qualified assignment? Here's the key factor here. And this was set forth in a private letter ruling, if you as the former employee recurrent deploy in a settlement, say, look, employer, don't pay me all this amounts, here in 2020. Let's spread it out the 2020 2021 and 2022 and 2023. Why don't we do that for a year. And let's suppose for these purposes, the settlement amount is $800,000. So we'll do that $200,000 each of the next four years, that way, my taxes will be high. And you know what the heck. Private letter ruling says you can do that. However, here's the key factor. You as the recipient can have no current claim to any of this money. And you can have no enforceable claim, ever. In other words, you are taking your former employer, the company who you just sued, who you think has done you terrible, terrible harm, enough to justify the payment of $800,000. And you're trusting them to each of the next two years for years. cut you a check for $200,000 no questions asked, and you have no right to enforce them to do that. That is a tough scenario for most of us to live with. And a really tough scenario to sell quiet on. I can tell you, not from hard experience blessedly, but I can tell you, that is not a an easy sell to make, nor should it be the way we address that is through these non qualified assignments. So in other words, the trust factor, which by the way, has a third component, we're assuming in 2024 that the employer will They'll be in business as such, or has not for some other unrelated or even related reason, filed for bankruptcy during this period or somehow brought themselves out of the realm of being a subject to the claims of non qualified credit or non

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creditors who are have no recourse, not a good place to be. Here, what we're doing is making a non qualified assignment to this annuity company. And the annuity company, then has the obligation to make these periodic payments in order to satisfy 2008, to 30 6019, the climate in this instance really has no current right to affect the timing of the periodic payments, nor legal capacity to monetize them. In other words, a claimant can say, hey, I've got this money waiting for me from this, this third party company, I'm gonna take it to a factoring company, and see if I can get 30 cents on the dollar on this can't do it. And specifically, there's a non outlet alienation clause that's required to be in any of these agreements. In other words, you are as a climate in no

better position than any other unsecured general creditor. So there are certainly substantial risks involved in this. And there are really, some very substantial transaction costs are involved with this, with the short answer being that is, if you wish to engage in an endeavor involving this kind of a structured settlement that is done pursuant to the private letter ruling that we mentioned, really, you should consult with a structured settlement advisor, there are many out there, many, most ones I deal with all are very, very reputable, and very, very trustworthy. If you don't have one in your jurisdiction, or you're not aware of one, again, I have a phone number at the back of the slides, feel free to give me a call or send me an email. And I'll be more than glad to make a recommendation for someone who could help you with this kind of a settlement. Um, I mentioned the tax cuts and JOBS Act. And we when we speak of that on slide 15, the tax cuts and JOBS Act went into law as as Pl 115 97, which was signed into law on December 22 2017. It suspends I mentioned something called a suspension period. What I was discussing was this suspension until 2026. of the deduction of miscellaneous itemized deductions under Section 212. And that in this instance, involves the deduction of attorneys fees, in cases other than employment cases. And this is where section 62 a 20 becomes much more significant. Six, we mentioned that it applies in cases of unlawful discrimination, and unlawful discrimination being defined extremely broadly. And allows for $1 for dollar deduction above the line, and basically a net zero consequence for these attorneys fees. In every other instance. However, in most other causes of action, attorneys fees are not deductible by individuals, at least pursuant to Section 212, which we use as a theory of expenses for the production of income. In this instance, if you for example, bring a case for defamation outside of the employment context, or for intentional infliction of emotional distress, that doesn't involve 104 a two because it involves a physical injury or physical injury or sickness, or for example, interference with contractual relations, any of these kinds of personal causes of action for which attorneys fees are a subject you whether you pay them whether a climate pays and it doesn't matter. They're not deductible and that has a very, very direct impact. On many, many causes of action, and it's a consequence that we're going to be living with until at least 2026, that the deadline for the expiration of this suspension period is actually December 31 2025. Five years from now.

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Moving forward to slide 16, one of the issues that came out of the tax cuts and JOBS Act, one that I spent an enormous amount of time working with. And as background, I had written several of the iterations have upset of the tax cut and JOBS Act, especially as involved excuse me employment tax situations, and including section 162 Q. In this race, very specific issues when section 162 q was actually drafted, which by the way, I didn't draft this iteration of it. And the problems that arose were attributable to the imprecise drafting of the subsection. And what it basically said was that no deduction shall be allowed under this chapter. For any settlement or payment related to sexual harassment or sexual abuse, if such settlement payment or payment is subject to a nondisclosure agreement, or attorneys fees related to such a settlement or payment.

What happened was we, in many in the bar, made the assumption that if you apply the strict black and white language of the statute as drafted, that we are forbidding the payment of attorneys fees, or the deduction of attorneys fees, by any party to this kind of case, in cloning the victim, including the recipient of those payments, in other words, overrode section six 162 a 20. And basically said, the price for having a nondisclosure agreement, and a case involving sexual harassment, sexual abuse is nobody gets to deduct their attorneys fees. Boy, that was a very, very tough outcome. And it scared an awful lot of people and caused an awful lot of distress. And the irony being that once this these two shoe was developed, for the most benign and laudable purposes, which was to provide a means for preventing employers, from having folks like when are the case that's pointed to always the Harvey Weinstein case, having abusive officers abusive and powerful executives, engage in this sort of conduct, and then get be able to deduct the attorneys fees and, and get the benefit of it. And this was meant to forestall that so that, you know, there were good laudable purposes behind it. But the way it was drafted simply opened the door to very, very bad consequences, the long and short of at night, and I I tell this to audiences all the time. The people in the IRS who administer these things are no less laudable and have no less concern than anybody else does. And they were very clear. And I said is the IRS is never going to force this in the way you're fearful of. And well, the truth of it is they won't and didn't. And we know this because on February 28 of last year of 2019, the IRS issued a set of frequently asked questions and question posed was does section 162 q preclude me from deducting my attorneys fees related to the settlement of my sexual harassment claim if the settlement is subject with non disclosure agreement, and the IRS said simply no. Recipients of settlements or payments related to sexual harassment or sexual abuse? Who settlement deceptive or non disclosure agreement are not precluded by section 162 q from deducting attorney fees related to the settlement payment, if there are otherwise deductible other words, in other words under Section 62, a 20. And then they refer to the pub 525. The publication we had spoken about earlier, this is a very, very good outcome. And frankly, the IRS did the right thing. And I don't think there was really any doubt that they would do the right thing that they would never ever have enforced. Section 162 q in the way we all were fearful But they would and frankly from if they applied the black letter law, as it is written, they would have been entitled to some a good outcome and something less, one fewer thing for us to worry about. Moving on to slide 19.

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We talked about the tax cuts and JOBS Act. And moving forward. One of the proposals was was an empower act that had been introduced by Kamala Harris, a name you may be familiar with. And Lisa Murkowski, both of whom were and are, as we speak, Senators, one democratic and one Republican. And what this would do would create an exclusion for non pecuniary damages from from six, IRS 62 week claims. And in other words, what it would do would say, for Section 62, weak claims, that is anything involving unlawful discrimination is very, very broadly defined, that will be excludable, from income, sort of like 104, a two, but not quite, because wages that is the portion

that's characterized as front back pay, and that sort of thing would still be includable as wages and treated as wages. And it will also allow for income averaging, so that someone doesn't get this big bump in one year, that puts them into a much higher tax category. But we'll try to recreate the economic effect, as if the employer had done the right thing all along and made the wage payments in earlier years. And then those are our years, the same economic effect, and that that, again, would be beneficial to everybody, because it will help make cases easier to settle as well. So we move forward on that, um, it's it's possible that if the Congress does a tax act this year, which under the new administration, it may very well. And so we'll see if President Elect Biden soon to be President Biden is able to bring this forward, obviously, the Vice President would be very supportive of a Tax Act that includes the provisions that that she had proposed under the power act. moving quickly move a little more quickly here. I had mentioned earlier, that there are consequences for an employee or, or anyone for that matter, who files a incorrect information return, for example, a form 1099, that's incorrect, or Form W two, that's an incorrect. Section 7434 actually provides a cause of action to remedy that sort of conduct, so long as it's fraudulent fraud being, of course, a higher bar and then most other cause of action. And if it is proven, if liability is found, then it provides for mandatory minimum, and I practice criminal law. As I mentioned earlier, some familiar with mandatory minimums. In this instance, it provides a mandatory minimum of $5,000 or the sum of actual damages, if more and also provides for the payment of reasonable costs and reasonable attorneys fees. As I mentioned a moment ago, fraudulent information return would include a Form W two a form 1099, or any other tax one, frankly, that the IRS would provide. There also is the possibility as we move to slide 22 of bring a whistleblower claim under seven sec, section 7623. A or B these are a little harder. In fact, they're they're much more demanding than 7434 windbag. But you could bring such a claim under the right circumstances in conjunction with with a 7434 claim. And once you bring the whistleblower claim, the IRS picks up the sword cudgel and moves the case forward. And at the end, moving to slide 23. You get paid? Hopefully, we're not as the case maybe. There is, by the way, under the whistleblower statute, one major distinction was we speak here. You have to show willfulness pursuant to 7434 under 7623, the whistleblower statute, it's not required that the claimant show willfulness again, The long and short of it though is under a whistleblower claim,

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you refer to the IRS, the IRS litigates it, then you hope that you get paid. So in other words, while you can make a claim you are or frankly, depending on the good offices, the heart and soul of the IRS to make a payment, and you're really at their their good wishes. And that may or may not be a comfortable position to be. But that's, that is where you are. And we're going to close out today's presentation with a very brief discussion of Section 409 Cafe, the big one, I'm big eight, which came into the law under the American jobs creation act of 2004. And I always point back one word for the enactment of Section 409. A, and that is Enron. This was all brought forth and justified at least in Congress by Enron and to some extent WorldCom. And these other companies,

which engaged in sweetheart transaction with their executives and their highly placed folks, and in kinds of transactions of involving non qualified deferred compensation arrangements, and non qualified retirement plans that the IRS viewed and Congress when viewed as being abusive. It's a tax that really only applies to the recipient, it's a big 20% tax, and an additional and over and above the tax ability, that would apply in any case, and it's, I can have very serious consequences. And it always comes up in cases involving a senior executive who's leaving employment. And because those are folks who typically will have a deferred compensation plan already in place, and who are subject to this kind of thing. The key point here, and we talked about the safe harbors here, and you can go through that on slide 26, which discusses the the factors that come that hit a that you can use a safe harbors, but the long and short of it is and really where the rubber meets the road in these kinds of cases, is that section four or nine cafe does not apply has no bearing whatsoever. In a case where you're bringing a bonafide legal claim. In other words, you have a case of wrongful termination or employment discrimination, we'll list these on one on slide 27, or an FSA case or worker compensation case. Um, if you have a real cause of action, under these, these theories, or discrimination or any other sort of factor, well, that brings you outside the ambit of 1409. Cafe by statute, by design, as a and again, the term of art is bona fide legal claim. So that's a powerful tool to have. And that is a very, very effective Safe Harbor. And, and so it shouldn't apply. If you are really bringing a cause of action on behalf of an executive you if you're filing a lawsuit, certainly, if you're threatening to file a lawsuit, certainly those come into play. Where this doesn't apply, though. And where the Safe Harbor is just simply not available, are instances where you don't have those kinds of bona fide legal claims. But in a severance agreement, as is almost always the case. There's the litany of potential claims that are being waived. And any lawyer who drafts in agreements such as this will put them in I've done it myself, it's a matter of course. And yes, you are always going to be required as a climate or as a as an employer, you're going to require the inclusion of this litany of claims the ADA the slsa every possible thing you can think of as being waived, that in and of itself, if all the in a severance agreement does not qualify as a bona fide legal claim as such, and thus does not provide a safe harbor from section 409 Cafe. Very, very important distinction, and one which can have very, very, very real world consequences. That's what we have today. Thank you very much for your time. I invite you if you have any questions to reach out, I'd be more than glad to try to help you or to point you in the right direction. You have my information here on slide 28 you can check me on my law firm website, www Leighton law comm send me an email at my firm site or call my offices 301390 6600 I'd be more than glad to try to address your concern. With that said thank you very much. This being the holiday season have a wonderful Happy Holiday have a safe and prosperous 2021 thank you and go forward. Bye bye