Trial Practice Corner

Avoid The IRS On Confidentiality Provisions

By Robin Frazer Clark

How did Dennis Rodman, former teammate of Michael Jordan on the Chicago Bulls, known for his defensive prowess and proliferation of tattoos, have a hand in the IRS decision that ultimately held confidentiality provisions to be taxable? Was Rodman as much as a lightning rod in tax court as he was on the basketball court?

In Amos v. Commissioner of Internal Revenue, No. 1339-01, (U. S. Tax Ct., December 1, 2003), the Federal Tax Court held that confidentiality provisions in releases of personal injury claims are of the nature of compensation for nonphysical injuries and, therefore, are subject to Federal taxation laws. This unfortunate Tax Court opinion stems from a personal injury suit filed by Plaintiff Eugene Amos, Jr. against NBA Celebrity, Dennis Rodman, for injuries Mr. Amos allegedly received during a Minnesota Timberwolves and Chicago Bulls basketball game when Mr. Rodman landed on a group of photographers, set up just off the court, and twisted his ankle. Mr. Rodman then kicked the group of photographers, of which Mr. Amos was one. Mr. Amos filed suit against Mr. Rodman for bruising to the photographer's groin area. Settlement negotiations ensued and, ultimately, resulted in a settlement agreement between the parties in the amount of $200,000.00. A mutual release, entitled "CONFIDENTIAL SETTLEMENT AGREEMENT AND RELEASE," was signed by both parties. This release contained a confidentiality provision that read, in part, as follows:

It is further understood that part of the consideration for this Agreement and Release includes an agreement that Rodman and Amos shall not at any time from the date of this Agreement and Release forward disparage or defame each other. It if further understood and agreed that, as part of the consideration for this Agreement and Release, the terms of this Agreement and Release shall forever be kept confidential and not released to any news media personnel or representatives thereof or to any other person, entity, company, government agency, publication or judicial authority for any reason whatsoever except to the extent necessary to report the sum paid to appropriate taxing authorities or in response to any subpoena issued by a state or federal governmental agency or court of competent jurisdiction.

Regrettably, counsel did not assign any specific dollar value to this provision. In Mr. Amos' tax return for that year, he excluded the $200,000.00 received in settlement of his case against Mr. Rodman. The Tax Court does not give any hint how the IRS became aware of this, but it audited Mr. Amos' tax returns and ruled that he was not entitled to exclude from his gross income the settlement amount in issue. Mr. Amos relied on that well-known, beloved tax code provision, Section 104 (a)(2), which states that damages received on account of personal physical injuries shall not be included in gross income. The dispute, then, was how much of the $200,000.00 should be considered consideration for the non-physical injury part of the settlement, i.e., the confidentiality provision. The Tax Court held that because Mr. Amos' attorney did not assign an identifiable portion of the settlement proceeds to the confidentiality provision, then the Tax Court itself, it its wisdom in evaluating personal injury cases, would do so. The Tax Court then decided, without sharing its roadmap of how it got there, that the confidentiality provision was worth a full $80,000.00, which was taxable income to Mr. Amos.

The moral of the story: assign a nominal dollar amount to any confidentiality provision in your releases. You may tell your client until you're blue in the face that you're not a tax attorney and that you can't give him or her any advice about tax consequences, but you are the final roadblock before the client signs that release and chances that he or she will insist on having the release for a couple of weeks before signing it so the client can consult with a knowledgeable tax attorney, we all know, are slim. The client is relying on you here, and one would probably have a tough time with a bar complaint or lawsuit in the event, albeit unlikely, that the IRS pokes its nose into a former client's personal injury settlement.

Consider assigning $1.00 in the release to the confidentiality provision. Mr. Amos argued that this amount was implied in the release he signed. The Tax Court does not buy this argument, but inherent in its discussion of the nominal amount is the belief that

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pealable issues, what the odds are of success given the court and current trends, and which issues, arguments, and facts to push and which to abandon. [34]

Even if you are unwilling to let another attorney ghost-write the brief or handle the oral argument (or if the relatively low stakes of the case make it uneconomical to do so), it is still often advisable to seek a second attorney to play devil's advocate with your arguments, to moot court your oral advocacy style, and to troubleshoot and edit your brief.

One expert described this last skill as particularly crucial to your chances of success:

Editing is probably the most neglected stage in the preparation of briefs. No one would think of publishing an unedited law review article, book, or [news] story . . . but lawyers are surprisingly casual about filing unedited briefs. . . . Editing should be regarded as an essential part of brief writing. . . . [T]he brief should be edited by someone other than the attorney who wrote it, preferably a lawyer who knows nothing about the case. This insures that the brief gets a fresh look during the edit. [35]

In the final analysis, just as it might be unwise and cause you to risk sanctions and a malpractice suit to allow a neophyte trial lawyer to make a closing argument to a jury in a major case, it might be equally foolhardy to allow an amateur appellate lawyer to handle that same case on appeal: "[B]eing a good trial lawyer does not mean that you are also a qualified appellate advocate." [36]

It's often best to leave brain surgery to the brain surgeons.

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1. KEVIN T. MCGUIRE, THE SUPREME COURT BAR: LEGAL ELITES IN THE WASHINGTON COMMUNITY 192 (1993).
2. Id., Table 8.2, at 184.
3. Robert Hinerfeld, Appellate Advocacy, L.A. LAWYER, Aug./Sept. 1990, at 35.
4. RICHARDSON R. LYNN, APPELLATE LITIGATION 83 (2d ed. 1993).
5. Id. at 1.
6. See generally RUGGERO J. ALDISERT, WINNING ON APPEAL 7-10 (1992).
7. ROBERT L. STERN, APPELLATE PRACTICE 20-21 (2d ed. 1989).
8. MICHAEL E. TIGAR, FEDERAL APPEALS: JURISDICTION AND PRACTICE 2 (rev. ed. 1993).
9. Id. at 2-3.
10. LYNN, supra note 4, at 6.
11. Randall T. Bell, To Write a Brief, in APPELLATE ADVOCACY SOURCE BOOK 3 (1980).
12. Charles F. Preuss, Federal Preemption of State Tort Actions: When and How, DEFENSE COUNSEL J., Oct. 1990, at 435, 444.
13. Eric J. Magnuson, Achieving Efficiencies in Appellate Cases, in APPELLATE PRACTICE FOR THE LITIGATOR 1 (1994).
14. Arthur J. England, Appellate Specialization, in APPELLATE PRACTICE FOR THE LITIGATOR 7 (1994).
15. LYNN, supra note 4, at 59.
16. HERBERT M. LEVY, HOW TO HANDLE AN APPEAL 18 (1990).
17. STERN, supra note 7, at 71 (citation omitted).
18. See Dennis J.C. Owens, New Counsel on Appeal, in ABA PRACTICE MANUAL 61 (1992).
19. John C. Godbold, Twenty Pages and Twenty Minutes--Effective Advocacy on Appeal, 30 SW. L.J. 801 (1976).
20. LYNN, supra note 4, at 3.
21. TIGAR, supra note 8, at 14 (citation omitted).
22. Magnuson, supra note 13, at 3.
23. LEVY, supra note 16, at 134-44.
24. STERN, supra note 7, at 72; Owens, supra note 18, at 62.
25. Gerald F. Uelman, The New Demands of Appellate Practice, CAL. LAW., Jan. 1994, at 57.
26. STERN, supra note 7, at 72 (quoting Judge Oliver Gasch).
27. ALDISERT, supra note 6, at 5.
28. STERN, supra note 7, at 72 (quoting Judge Oliver Gasch).
29. LYNN, supra note 4, at 147-57, 188-89.
30. ABA MODEL RULES OF PROFESSIONAL CONDUCT Rule 1.1. Compare MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 6-101(A). See generally LYNN, supra note 4, at 68-71.
31. LYNN, supra note 4, at 69 (citation omitted).
32. Id. at 9
33. See generally id. at 14-17; STERN, supra note 7.
34. LEVY, supra note 16, at 20-21; LYNN, supra note 4, §§8.1-8.3; Magnuson, supra note 13, at 2 ("Often the most economical appeal is the one never taken. . . . The decision to appeal should not be a reflex action, and an appellate lawyer is in a good position to make a dispassionate and rational recommendation on the merits of an appeal.").
35. Bell, supra note 11, at 21-22.
36. ALDISERT, supra note 6, at 4-5. ❖

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had Mr. Amos' attorney simply included one more sentence in the release, i.e., that both parties agree the value of the confidentiality provision is $1.00, it would have never become an issue. Some plaintiffs' lawyers have suggested using Amos on the offensive to get some real, substantial value for the inclusion of confidentiality provisions in releases. This is certainly one way to handle it, but you would also be required to advise your client that portion of the settlement would be considered taxable income to him or her. Knowing full well that advising a client on taxation consequences, for me, would be tantamount to advising him on what the tensile strength of concrete is, I would just as soon avoid that conversation. Can you negotiate the settlement as if the confidentiality provision was worth considerable value and then state in the release its value is only $1.00? Yes, of course, as long as you know your defense counsel has a good sense of humor. If unsure, tread lightly when assigning any value of $1.00 to a confidentiality provision.

Good luck with those releases and confidentiality provisions. Now that you know about this potential snare, don't let it come back to haunt you. ❖