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Tax Alert



Robert W. Wood

THE TAX LAWYER

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Bill Would Make Wrongful Conviction Awards Tax-Free

Congressmen [Sam Johnson](#) (R-TX) and [John Larson](#) (D-CT) have introduced legislation to prohibit the IRS from taxing compensation awarded to anyone wrongfully convicted of a crime and later exonerated. Is this bill necessary or a good idea? Yes on both counts.

More and more prisoners are being [exonerated based on DNA](#) or other evidence. Under statute, by lawsuit or even by legislative grant, exonerees may receive compensation for their years behind bars. See [Ex-Inmate Struggles to Cash In on Texas Law That Pays for Years of Wrongful Imprisonment](#). In fact, are you ready for some shocking figures?

Since the first DNA exoneration in 1989, wrongfully convicted persons have served more than 3,809 years in prisons across 35 states before being exonerated. The nearly 300 DNA exonerees served an average of 13.5 years in prison, ranging from less than one year to 35 years. Whether you look at an individual case or at the averages, these are some

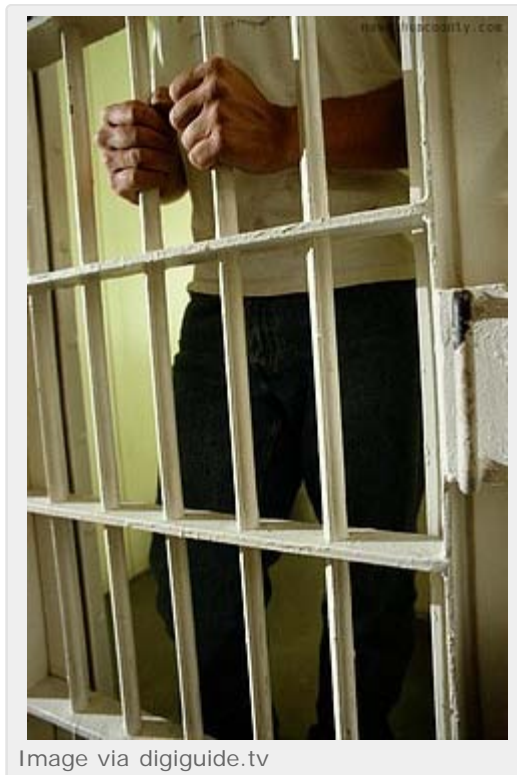


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astounding numbers. See [Congressmen Sam Johnson and John Larson Press Release](#).

The tax issues have been surprisingly cloudy. In the 1950s and 1960s, the IRS ruled prisoners of war, civilian internees and holocaust survivors received tax-free money for their loss of liberty. In 2007, the IRS “obsoleted” these rulings suggesting the landscape had changed. The IRS now asks whether a wrongfully jailed person was physically injured/sick while unlawfully jailed. If so, the damages are tax free, just like more garden variety personal physical injury recoveries. See [IRS To Collect on Italian Cruise Ship Settlements](#).

What if an exoneree isn’t physically injured? In IRS [Chief Counsel Advice 201045023](#), the IRS said a recovery was exempt, but the IRS sidestepped whether being unlawfully incarcerated is *itself* tax-free. The Tax Court (and [Sixth Circuit](#)) in [Stadnyk](#) suggest persons who aren’t physical injured may be taxed. See [Why the Stadnyk Case on False Imprisonment Is a Lemon](#).

There are usually significant physical injuries and sickness but not always. Besides, what about the money just for being locked up? What if an exoneree gets \$50,000 for physical injuries and \$450,000 for being unlawfully behind bars?

The loss of physical freedom should be tax-free in its own right. Many exonerated individuals experience severe hardship acclimating to society, finding jobs, housing and reconnecting with family. [The Wrongful Convictions Tax Relief Act](#) proposes to allow exonerees to keep their awards tax-free.

According to [Congressman Larson](#), “Though we can never give the wrongfully convicted the time back that they’ve had taken from them, they certainly shouldn’t have to pay Uncle Sam a share of any compensation they’re awarded. This bill will make sure they don’t have to suffer that insult on top of their injury.”

The two Congressmen are right. It is bad social justice and bad tax policy to tax these recoveries. It is also unfair to leave the tax law murky so some people are paying tax.

For more, see:

[Freedom after nearly 25 years of wrongful imprisonment](#)

[Wrongful Imprisonment Tax Ruling Stirs Controversy](#)

[Tax On Wrongful Imprisonment Needs Reform](#)

[Tax-Free Wrongful Imprisonment Recoveries](#)

[Should False Imprisonment Damages Be Taxable?](#)

[Why False Imprisonment Recoveries Should Not Be Taxable](#)

[A 'Get Out of Jail' Card That's Far From Free](#)

[Are False Imprisonment Recoveries Taxable?](#)

*Robert W. Wood practices law with [Wood LLP](#), in San Francisco. The author of more than 30 books, including *Taxation of Damage Awards & Settlement Payments* (4th Ed. 2009 with 2012 Supplement, [Tax Institute](#)), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*