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Tax Alert



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New Law Says Money For Wrongful Convictions Is Tax Free

Many of us are discovering surprises in the massive so-called tax extenders package. With more than six hundred *billion* tax dollars at stake, it is easy to get overwhelmed. Arguably one of the least noticed and yet most defensible changes to the tax code in this sausage-filled bill is something that for years was proposed as the stand-alone “Wrongful Convictions Tax Relief Act.” Unlike many other tax changes, you do not want this to apply to you. Because if it does, you were wrongfully convicted and wrongfully behind bars.

In the U.S., individuals who have been wrongfully convicted and exonerated by DNA evidence spent on average 14 years wrongfully incarcerated. The new law amends the Internal Revenue Code so a wrongfully incarcerated individual can exclude from taxes the civil damages, restitution, or other monetary awards he or she receives as compensation for a wrongful incarceration.



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. Hundreds of DNA exonerees have 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 astounding numbers, as [Congressmen Sam Johnson and John Larson have noted](#).



Congressmen [Johnson](#) (R-TX) and [Larson](#) (D-CT) introduced their bill repeatedly, but didn't give up. In 2015, they [re-introduced](#) the [Wrongful Convictions Tax Relief Act](#). Several members of the Senate, including Charles Schumer (D-NY) and John Cornyn (R-TX), joined in. Thirty states, the District of Columbia, and the federal government provide some form of statutory compensation for wrongful conviction and incarceration. But the only thing the tax law has allowed is that if you are physically *injured* while in prison and get money for your injuries, *that amount* is tax free. That's the same rule is you were injured outside prison in a car wreck, a slip and fall, or skiing accident.

The new law says you no longer have to prove that you were physically injured in prison to get tax free treatment. You also no longer have to fudge the allocation of the money. You no longer need to suggest that you received millions for getting stabbed or beaten up while in prison, and nothing for spending 15 years wrongfully behind bars.

Injustices happen, and when they do and are eventually rectified, the person is never the same. This includes re-entry needs that are hard to comprehend. For the few who end up with money for their ordeal, adding the IRS collectors into the mix was always a bad idea. Yet until now, the tax issues have been surprisingly cloudy.

In the 1950s and 1960s, the IRS ruled that 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 thereafter asked whether a wrongfully jailed person was physically injured/sick while unlawfully jailed. If so, the damages were tax free, just like more garden variety personal physical injury recoveries.

In IRS [Chief Counsel Advice 201045023](#), the IRS sidestepped whether being unlawfully incarcerated is *itself* tax-free. The Tax Court and [Sixth Circuit](#) in [Stadnyk](#) suggested that persons who aren't physical injured during their [imprisonment](#) should be taxed.

Finally, though, [the Wrongful Convictions Tax Relief Act](#) allows 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."

For alerts to future tax articles, email me at Wood@WoodLLP.com. This article is not legal advice.