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TAXES 06/25/19

Wrongful Life And Wrongful Birth Damages, Taxable or Tax-Free?

As medicine, science, and the law continue to develop, lawsuits for wrongful birth and wrongful life are increasingly being recognized. Wrongful birth actions are brought by parents to recover for the birth of an unhealthy child. The parents' right to recover is based on the defendant's negligent deprivation of their right to *not* conceive the child, or to prevent the child's birth. In contrast, wrongful life actions are brought by the child but parallel a wrongful birth cause of action. Both kinds of cases generally involve medical evidence and damage studies that focus on the life-care needs of a disabled or ill child. States vary in whether they allow either or both kinds of cases, but if a parent or child sues and recovers a settlement or judgment, is it taxable?

Damages for personal physical injuries (like an auto accident or slip and fall case) are tax-free. So are damages for physical sickness. But punitive damages and interest are taxable, as are damages for emotional distress. Up until 1996, just about anything qualified as tax free personal injury damages, including emotional distress, defamation or invasion of privacy. In 1996, the tax code was changed so only recoveries for personal *physical* injuries or *physical* sickness qualify. Unfortunately, the IRS is notoriously tough on what is physical. Traditionally, it means injuries you can see like bruises or broken bones. How do wrongful life and wrongful birth damages stack up to this standard? For a wrongful life claim, a plaintiff child's personal physical injury or physical sickness may be clear, and damages are usually assessed based on the additional medical and special needs of the child.

That arguably goes a long way toward the tax-free standard. With both types of cases, pay attention to the particular language in the settlement agreement.

Ideally, consider these issues *before* the settlement documents are finalized. In wrongful birth cases, the defendant's actions take away the parent's right to make an informed decision on whether to carry a fetus to term. In that sense, the defendant caused the birth, and thereby caused the physical injury or disability. Except for the defendant's negligence, the child's medical condition would not have had the opportunity to manifest itself, with the resulting medical and life-care expenses.



It may not matter to the tax treatment whether it is the child or the parents who receive the damages. The IRS has repeatedly suggested that the nature of the damages is more important than who is receiving them. For example, survivors or bystanders may receive damages for someone else's injuries or death, but they may still be entitled to tax-free treatment. The legislative history of the tax code section says that all non-punitive damages that flow from a physical harm can be excluded, regardless of whether the recipient of the damages is actually the injured party.

With wrongful life or wrongful birth damages, the funds are meant to pay for the stress of caring for an ill or disabled child and the attendant costs. The parents are receiving the funds, but they are really receiving them on account of the injuries to or special needs of the child. It is conceivable that the IRS could classify these damages as emotional distress recoveries. However, using

strong tax language in settlement agreements may keep the issue from arising. Stressing the nature of the damages and the medical failures in question should help. So, too, should statements that the settlement payment is being made on account of medical expenses, physical injuries, physical sickness, and emotional distress they caused.

This is not legal advice. For tax alerts or tax advice, email me at Wood@WoodLLP.com.