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### Dead Cruise Ship, Clogged Toilets, Scant Food, No Carnival

A fire broke out in an engine room of the Carnival Triumph 150 miles off the coast of Mexico's Yucatan Peninsula, heading for Galveston, Texas. The fire was quickly contained, but passengers are making do with few working toilets and little food. While no injuries were reported, 3,143 passengers and 1,086 crew are adrift. Tugboats are towing the ship to Mobile, Alabama, where it is expected Thursday.



Photo of the Carnival Triumph at Half Moon Cay (Photo credit: Wikipedia)

See [Stinking Carnival cruise ship being towed to Alabama](#).

There are issues with running water, electricity and food, with reports of open sewage and passengers being asked to defecate in bags and urinate in showers. Food lines can run 3½ hours long. See [Cruise ship still gross, passengers say, but it's finally moving](#). This cruise may be more inconvenience than disaster, but once passengers are home safely, legal action and settlements seem likely.

If so, will settlements be taxed? Remember the Italian cruise ship disaster? In that case, Carnival Cruises offered uninjured passengers €11,000 (\$14,460) each [to compensate them for lost baggage and psychological trauma](#). They were also reimbursements for cruise, travel

and medical expenses. That deal only covered those who suffered no physical harm, not the roughly 100 people injured or families who lost loved ones.

If you get a settlement for a ruined vacation, it probably will be taxed. Generally, everything is income to the IRS. Fortunately, damages for physical injuries (say, broken bones from an accident) are tax-free. What if you only suffer emotional distress from a ruined vacation, upsetting sanitation, etc?

Damages for physical sickness are tax-free, but not physical symptoms caused by emotional distress—say, headaches. Neither the IRS nor Congress has clarified what’s physical and what’s not, so tax disputes are common. The U.S. Tax Court overruled an IRS decision to tax a \$350,000 settlement a man received after suing his ex-employer for intentional infliction of emotional distress. See [Parkinson v. Commissioner](#). Why? The distress led to a heart attack, the court said. See [Tax-Free Physical Sickness Recoveries in 2010 and Beyond](#).

A cruise ship settlement for “emotional distress” is taxable. However, if a passenger got post-traumatic stress disorder, [is PTSD physical injury for tax purposes?](#) Arguably yes, even if they are hyper-sensitive. There also could be tax issues with property settlements.

If a passenger loses possessions and is reimbursed, the cash could be taxed. Still, passengers should be able to recover their basis before they have income. That could mean only the excess is taxed. Of course, proof problems can be severe—who keeps receipts for personal items? For tips, see [Need A Tax Receipt?](#)

How the settlement is reported to you (on IRS [Forms 1099](#)) can matter. You have more flexibility to reduce taxes if you negotiate your settlement with an eye on tax rules. The IRS isn’t bound by an agreement’s wording, but it can help.

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