

# Doron F. Eghbali Business Law

## Would You Have to Pay Taxes on Personal Injury Awards?

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Hopefully, we never have to worry about personal injury awards we receive. However, if such eventuality befalls us, we *generally* need not be worried about reporting such awards for income taxes purposes. Let us further analyze this.

### **NONTAXABLE INCOME: PAYMENTS FOR PHYSICAL INJURIES AND SICKNESS**

GENERALLY, awards received as compensation for physical injury or physical sickness is federally income-tax free. It does not matter if the compensation received as part of out of court settlement or court-ordered compensation.

Moreover, any compensation for infliction of emotional distress that arises from physical injury or physical sickness is also federally income-tax free.

In addition, the part of compensation paid for lost wages is also federally income-tax free. This is a paradox since if you had obtained such wages as part of your gainful employment, you must have reported them for your taxes.

As importantly, medical expenses you paid out of your pocket are also tax free. However, to the extent you claimed tax deduction for such expenses, you have to report them.

Also, if the IRS deems any part of the award you receive as some kind of interest for the period between the time of physical injury or sickness to when you receive the compensation, then you usually must pay taxes on that portion.

### **TAXABLE INCOME: LEGAL INJURIES AND PUNITIVE DAMAGES**

#### **1. GENERALLY, LEGAL INJURIES ARE TAXABLE**

The IRS views legal injuries as different from physical injuries. In the eyes of the IRS, compensation received from legal injuries is taxable.

Not Exhaustive taxable list of legal injuries is provided here:

- Compensation for Injuries from Harassment
- Compensation for Injuries from Libel
- Compensation for Injuries from Invasion of Privacy
- Compensation for Injuries from Infliction of Emotional Distress (Not Arising from Physical Injury)
- Compensation for Injuries from Discrimination
- Compensation for Injuries from Wrongful Termination

## **2. GENERALLY, PUNITIVE DAMAGES ARE TAXABLE**

GENERALLY, damages paid to punish the the person found to have inflicted harm are taxable. This type of damages is referred to as punitive damages. Punitive damages ARE *GENERALLY* TAXABLE. Except, when the general damages are awarded in a civil wrongful death actions, such punitive damages are not taxable, if pertinent state laws allow such damages.

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