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Are PTSD Recoveries Tax Free?

If you are injured in a car accident, your physical injury settlement should be tax free. See [Section 104](#). However, any punitive damages and interest will be taxed. See [Tax-Free Wrongful Death Punitive Damages?](#) But if you sue for discrimination or harassment at work, your wage loss will be subject to withholding, and any other monies are likely to be taxed too. Such are the sometimes complex tax rules governing the payment of legal settlements and judgments. See [10 Things To Know About Taxes On Damages](#).

The rules are the same whether your case is settled or proceeds to judgment, although there is nearly always more flexibility when a case settles. If you get tax advice *before* your settlement is documented, you can often improve on the tax result. See [Address Taxes When You Mediate Civil Disputes](#). The IRS isn't bound by the parties' tax characterization, but it is often respected if reasonable.

One of the bones of contention is just what constitutes personal physical injuries or sickness. The IRS hasn't defined it, but normally wants to see "observable bodily harm" such as bruises or broken bones. If the case arises out of employment, the IRS knee-jerk reaction is that such recoveries are wage loss or are otherwise taxable. See [The IRS Speak Out On Employment Lawsuit Settlements](#).

Recently though, the Tax Court ruled an employee suit may be partially tax free if the employee has physical sickness from working conditions. It must be much more than merely emotional distress. In one case, stress

at work produced a heart attack (see [Is Physical Sickness the New Emotional Distress?](#)), and in another, stressful conditions exacerbated the worker's pre-existing multiple sclerosis. See [Tax-Free Physical Sickness Recoveries in 2010 and Beyond](#).

PTSD? So far, the [tax treatment of post traumatic stress disorder \(PTSD\)](#) isn't clear. Yet medical data suggests PTSD is no mere mental state. In fact, it is a physical sickness involving measurable changes in the physical makeup of the brain and nervous system. See [The Biological Effects Of Traumatic Events](#) and [Neuroscientists Say Brain Scans Can Spot PTSD](#). U.S. Taxpayer Advocate Nina Olson has advocated for [treating PTSD as physical sickness](#), meaning that settlements for it would be tax free.

In my view that should be true whether the PTSD is caused by military service overseas, witnessing a family member run down in traffic, or being harassed at work. We'll see whether the IRS agrees.

For more, see:

[Bruises, Settlements, and the Proposed 104 Regs](#)

[Tax on Employment Settlements Addressed by IRS](#)

[Ten Tax Rules Litigators Should Know](#)

[Symptoms of Emotional Distress vs. Sickness: Sheep From Goats](#)

[Getting Physical: Emotional Distress and Physical Sickness](#)

[Tax Dangers In Preparing Settlement Checks](#)

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