



Robert W. Wood
THE TAX LAWYER

TAXES | 5/27/2013

Post Traumatic Stress Disorder And Taxes

If you are physically injured in military service or as a private citizen, payments you receive to compensate you for your injuries are tax-free. If you receive payments for an injury that isn't physical or has no outward signs like bruises or broken bones, the rules are less clear. This Memorial Day, we should be especially reminded that so-called invisible war wounds such as Post Traumatic Stress Disorder (PTSD), Traumatic Brain Injury, and various mental health issues can be just as debilitating as more obvious injuries. See [On A Reflective Memorial Day, Remember The Invisible War Wounds](#).



Such invisible wounds can aggravate other problems and lead to joblessness, homelessness and suicide. Although any payment for physical injury should be tax-free under [Section 104](#), punitive damages and interest are taxed. If you sue for discrimination or harassment at work, any 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, but 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 often respects it if it is reasonable.

The rules for what constitutes personal physical injuries or sickness aren't clear but the IRS normally wants to see "observable bodily harm." Think bruises or broken bones. If the case arises out of employment, the IRS says recoveries are wage loss or are otherwise taxable. See [IRS Speaks Out On Employment Lawsuit Settlements](#).

However, 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](#).

The [tax treatment of 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.

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.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.