

## President Obama and Damages for PTSD

by Robert W. Wood



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In this article, Wood argues that post-traumatic stress disorder can be considered a physical injury for which court-awarded damages should be free from tax.

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President Obama was asked about post-traumatic stress disorder during a September 2016 CNN presidential town hall concerning national security, foreign policy, and veteran issues affecting the U.S. military. Obama said:

I have instructed the Joint Chiefs and up and down the chain of command that they have a responsibility to destigmatize mental health issues and issues of PTSD and help to explain to everybody in all of the units under their command that there's nothing weak about asking for help. If you break your leg, you're going to go to a doctor to get that leg healed. If, as a consequence of the extraordinary stress and pain that you are witnessing, typically, in a battlefield, something inside you feels like it's wounded, it's just like a physical injury. You've got to go get help. And there's nothing weak about that. That's strong. And that is

what will allow you then to continue to — with your service and there shouldn't be a stigma against it.<sup>1</sup>

The Department of Veterans Affairs' National Center for PTSD estimates that 7.8 percent of Americans will suffer from PTSD at some point in their lives.<sup>2</sup> The National Center for PTSD reports that 11 percent to 20 percent of veterans who served in Iraq and Afghanistan suffer from PTSD in any given year.<sup>3</sup> Yet, an estimated 85 percent of cases result from an event *outside* the military.<sup>4</sup>

With increasing diagnoses, allegations in litigation that a defendant caused or exacerbated a plaintiff's PTSD are no longer rare. They occur in medical or benefits litigation, employment claims, and other contexts. PTSD can develop after a threat of physical trauma and is said to damage the natural fight-or-flight response to perceived danger.<sup>5</sup>

PTSD may manifest itself in flashbacks, insomnia, headaches, depression, and stomach disorders. Relevant events include sexual violence, a car accident, or the violent death of a friend or family member.<sup>6</sup> Outside the military, women are twice as likely as men to develop PTSD.<sup>7</sup> The Social Security Administration classifies some PTSD sufferers as disabled.<sup>8</sup>

For tax purposes, are damages for PTSD physical, emotional, or both? The question is of increasing importance. Damages paid because of PTSD might be characterized as paid because of a mental or emotional injury (taxable) or as physical sickness (tax free). The recent comments about PTSD by

<sup>1</sup>CNN Presidential Town Hall: *America's Military and The Commander and Chief*, CNN Press Room (Sept. 28, 2016).

<sup>2</sup>See Alexandra Wolfe, "A Psychiatrist's Quest to Understand PTSD," *The Wall Street Journal*, Jan. 6, 2017.

<sup>3</sup>*Id.* Other studies claim that approximately 25 percent of the 2.6 million returning veterans from Afghanistan and Iraq since September 11, 2001, have been diagnosed with PTSD. See News21 Staff, "Returning Iraq and Afghan War Vets Find Little Government Support, Investigation Finds," Florida Center for Investigative Reporting, Aug. 26, 2013.

<sup>4</sup>*Id.*

<sup>5</sup>National Institute of Mental Health, "What Is Post-Traumatic Stress Disorder?" (Feb. 2016).

<sup>6</sup>See Wolfe, *supra* note 2.

<sup>7</sup>*Id.*

<sup>8</sup>*Laskowski v. Department of Veteran Affairs*, No. 3:10-cv-600-JMM, at 17 (M.D. Pa. 2013); see also Social Security Administration, "Apply Online for Disability Benefits."

Obama reinforce the view that PTSD recoveries should be seen as physical and free from tax.

### Disabilities and Physical Injury Damages

The lack of clarity in the tax treatment of awards of PTSD-based damages can be awkward for both plaintiffs and defendants. Since 1918, section 104 has generally made compensatory damages in personal injury cases tax free. However, in 1996 section 104 was amended so that its exclusion applies only to recoveries for *physical* injuries and *physical* sickness, not emotional distress.

Although this physical modifier was added 20 years ago, no published rulings or regulations have directly tackled the physical requirement, much less how it applies to PTSD.<sup>9</sup> For years, the IRS required observable bodily harm (like cuts or bruises) for an exclusion.<sup>10</sup> Then, in an important 2008 ruling, the IRS excluded a recovery for sexual molestation, even though payment was made years later when no observable bodily harm could be shown.<sup>11</sup>

More generally, the IRS seems to recognize that physical and emotional injuries may sometimes be inextricably entwined.<sup>12</sup> Arguably, PTSD is physical, and Obama appears to agree. Although some

<sup>9</sup>See Nina Olson, “National Taxpayer Advocate 2009 Annual Report to Congress,” at 356 (Dec. 31, 2009). (“Since the amendment of IRC section 104(a)(2) in 1996, the scientific and medical community has demonstrated that mental illnesses can have associated physical symptoms. Accordingly, conditions like depression or anxiety are a physical injury or sickness and damages and payments received on account of this sickness should be excluded from income. Including these damages in gross income ignores the physical manifestations of mental anguish, emotional distress, and pain and suffering.”).

<sup>10</sup>See LTR 200041022 (“We believe that direct unwanted or uninvited physical contacts resulting in observable bodily harms such as bruises, cuts, swelling, and bleeding are personal physical injuries under section 104(a)(2).”).

<sup>11</sup>See CCA 200809001 (“C has alleged that Entity’s agent(s) X caused physical injury through Tort while he was a minor under the care of X. . . . Because of the passage of time and because C was a minor when the Tort allegedly occurred, C may have difficulty establishing the extent of his physical injuries. Under these circumstances, it is reasonable for the Service to presume that the settlement compensated C for personal physical injuries, and that all damages for emotional distress were attributable to the physical injuries.”); see also discussion in Robert W. Wood, “IRS Allows Damages Exclusion Without Proof of Physical Harm,” *Tax Notes*, Mar. 31, 2008, p. 1388.

<sup>12</sup>See comments of Michael Montemurro, branch 1 chief, IRS Office of Associate Chief Counsel (Income Tax and Accounting), “Public Hearing on Proposed Regulations, 26 CFR Part 301, ‘Damages Received on Account of Personal Physical Injuries or Physical Sickness,’” at 10 (REG-127270-06) (“I mean I don’t know that the Service has ever gone to court on litigation, you know, I know the Service doesn’t ever go to court on litigation, [regarding] anybody who’s been falsely imprisoned or anyone who’s suffered any sex abuse, as far as asserted in a courtroom that those kinds of damages are taxable, I mean whatever the pure technical answers may be.”).

non-tax courts have determined that PTSD is not a physical injury,<sup>13</sup> the tax law should not take this narrow view.

Indeed, PTSD recoveries under workers’ compensation acts are tax free even if the disability is *not* physical.<sup>14</sup> Section 104(a)(4) also excludes from income amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces. Neither of these subsections requires the injuries or sickness to be *physical*.

Yet outside those cases, PTSD damages would have to meet the “physical” requirement to be tax free. PTSD after physical injuries, such as veterans who have lost limbs or sight in battle, clearly should qualify. A physical injury catalyst brings along even garden-variety emotional distress damages to entitle them to exclusion.

What about damages for PTSD without physical injuries? For example, what about a veteran who has PTSD as a result of witnessing the deaths of fellow soldiers, or a plaintiff who now suffers from PTSD after being kidnapped? The case for tax-free treatment based on such physical catalysts remains strong.

And surely that is true even if the physical catalyst is not as obvious. Workplace harassment may be verbal and yet in some cases may directly lead to PTSD. Given what we now know from brain imaging, PTSD itself should be viewed as physical sickness or observable bodily harm.

PTSD alters the physical structure of the brain just as the physical structure of a heart is altered by a heart attack. Researchers can survey the human brain more thoroughly than with conventional X-ray or CT scans,<sup>15</sup> and a person with PTSD shows higher levels of cortisol.<sup>16</sup> Cortisol plays a key role

<sup>13</sup>See *Curtis v. Department of Justice*, 342 Fed. Appx. 610 (Fed. Cir. 2009); *Parker Drilling Offshore United States LLC v. Campbell*, 323 Fed. Appx. 330 (5th Cir. 2009).

<sup>14</sup>See section 104(a)(1).

<sup>15</sup>Advances in MRI allow neurologists to examine the brain at 1-millimeter resolution, in color and three-dimensional, enabling detections in small changes in brain activity. See Justin Berton, “PTSD Leaves Physical Footprints on the Brain,” *S.F. Gate*, July 27, 2008.

<sup>16</sup>Eileen Delaney, “The Relationship Between Traumatic Stress, PTSD, and Cortisol,” U.S. Naval Center for Combat and Operational Stress Control (May 14, 2013), citing B.M. Elzinga et al., “Higher Cortisol Levels Following Exposure to Traumatic Reminders in Abuse-Related PTSD,” *28 Neuropsychopharmacology* 1656 (2003).

to direct urgent physiological and metabolic processes, and individuals with PTSD generally have altered cortisol levels.<sup>17</sup>

Child abuse victims with PTSD experience enhanced cortisol activity in response to exposure to traumatic reminders.<sup>18</sup> PTSD sufferers also exhibit a reduced hippocampus, a part of the brain playing a major role in short-term memory and emotions. Like a shrunken limb, this part of the PTSD sufferer's brain is up to 20 percent smaller.<sup>19</sup>

Patients suffering from PTSD show altered activity in the amygdala (regulating emotional memory) and insular cortex (negative emotion).<sup>20</sup> The amygdala shows hyperactivity, and the insular cortex shows hypoactivity.<sup>21</sup> These effects are observable with equipment, and outward manifestations of PTSD are often apparent.<sup>22</sup>

Long before Obama's remarks, National Taxpayer Advocate Nina Olson stated that PTSD disorders are physical injuries for purposes of section 104.<sup>23</sup> The departments of the Treasury, Labor, and Health and Human Services have found the line between emotional and physical injury is increasingly tenuous. In 2013 those three departments issued final regulations so that mental health or substance use disorder benefits are equivalent to medical and surgical benefits.<sup>24</sup>

<sup>17</sup>The hypothalamus links the nervous system to the endocrine system. It controls body temperature, hunger, thirst, fatigue, and sleep.

<sup>18</sup>See Delaney, *supra* note 16.

<sup>19</sup>M.W. Gilbertson et al., "Smaller Hippocampal Volume Predicts Pathologic Vulnerability to Psychological Trauma," 5 *Nat. Neuroscience* 1242-1247 (2002).

<sup>20</sup>The amygdala is located in the temporal lobes of the brain and helps process memory and emotional reactions. The insular cortex is located within the lateral sulcus of the brain and regulates a person's perception, motor control, self-awareness, and cognitive functioning. See Amit Etkin and Tor Wager, "Functional Neuroimaging of Anxiety: A Meta-Analysis of Emotional Processing in PTSD, Social Anxiety Disorder, and Specific Phobia," 164 *Am. J. Psychiatry* 1476 (Oct. 1, 2007).

<sup>21</sup>Michael Koenigs and Jordan Grafman, "Post-Traumatic Stress Disorder: The Role of Medial Prefrontal Cortex and Amygdala," 15 *Neuroscientist* 540-548 (Oct. 2009).

<sup>22</sup>These include depression, withdrawal, moodiness, and unpredictable temperament.

<sup>23</sup>Olson, *supra* note 9, at 355-356; see also Olson, "National Taxpayer Advocate 2013 Annual Report to Congress," at 2 (Dec. 31, 2013) ("Since the amendment of IRC section 104(a)(2) in 1996, the scientific and medical community has demonstrated that mental illnesses can have associated physical symptoms. Accordingly, conditions like depression or anxiety are a physical injury or sickness and damages and payments received on account of this sickness should be excluded from income. Including these damages in gross income ignores the physical manifestations of mental anguish, emotional distress, and pain and suffering.")

<sup>24</sup>Section 9812 required "processes, strategies, evidentiary standards, and other factors used by the plan or issuer" to be

(Footnote continued in next column.)

Some courts have considered PTSD to be a physical injury. In *Helm*,<sup>25</sup> a firefighter suffered from PTSD after responding to an emergency where two young boys were suffocating in the trunk of a car. The firefighter argued that PTSD "causes physiological changes in the brain itself, [and] therefore it is a physical injury." The court found that PTSD was a physical injury to the brain.

In *Werline*,<sup>26</sup> the court recognized that PTSD caused physical and emotional injuries, even though the case was pled as one for negligent infliction of emotional distress. The court observed that there is "no recognizable clean-cut [line] that would allow the court to partition off" emotional injuries from physical injuries affiliated with PTSD.

### Emotional Distress From PTSD

Treating PTSD as a physical injury for purposes of section 104 means that *emotional* distress damages *arising from* PTSD should also be tax free. The section 104(a)(2) exclusion applies to damages received based on a claim of emotional distress that is because of personal physical injuries or physical sickness.<sup>27</sup> Some courts have held that payments for insomnia, headaches, and stomach disorders are taxable as mere symptoms of emotional distress.<sup>28</sup>

However, the courts have recognized that these symptoms may arise because of physical sickness or physical injury and can be characterized as "objective indications of a disease" rather than merely "subjective sensations."<sup>29</sup> In LTR 200041022, often called the "bruise ruling," the IRS ruled that emotional distress injuries sustained *after* physical injury are tax free. The Tax Court too is breaking down bright-lines between physical and emotional injuries.

For example, in *Parkinson*,<sup>30</sup> the taxpayer suffered a heart attack because of stress on the job. The IRS argued that the settlement was not excludable because the claim was for emotional distress. The Tax

"comparable to, and be applied no more stringently for, mental health or substance use disorder benefits than for medical surgical benefits." T.D. 9640.

<sup>25</sup>*City of Norman v. Helm*, Okla. Civ. App. 106 (2012).

<sup>26</sup>*Werline v. CSX Transportation*, U.S. Dist. LEXIS 137028, at 10 (2010).

<sup>27</sup>PMTA 2009-035; see also *Commissioner v. Schleier*, 515 U.S. 323 (1995).

<sup>28</sup>See *Sanford v. Commissioner*, T.C. Memo. 2008-158; see also *Blackwood v. Commissioner*, T.C. Memo. 2012-190 (holding that payments for depression symptoms of insomnia, oversleeping, migraines, nausea, and vomiting were for emotional distress and not excludable from income); *Murphy v. IRS*, 493 F.3d 170 (D.C. Cir. 2007) (court considered sleeplessness, stomachaches and headaches "minor and transitory" and did not exclude payments for these symptoms).

<sup>29</sup>*Parkinson v. Commissioner*, T.C. Memo. 2010-142.

<sup>30</sup>*Id.*

Court sensibly viewed a heart attack as physical, not merely a symptom of emotional distress.

The *Parkinson* court explained that an examining physician could clearly diagnose a heart attack's physical effects. In *Domeny*,<sup>31</sup> another important case, Julie Domeny's multiple sclerosis (MS) was exacerbated by stressful job conditions. Her symptoms of MS included shooting pain, fatigue, burning eyes, vertigo, and light-headedness.

Although Domeny was not physically touched, and her stressors were emotional, the court sensibly held that her damages should be tax free. There was no PTSD diagnosis, yet the Tax Court concluded that the settlement was excludable because it was for physical illness. As with a heart attack, PTSD triggers entrenched physical (and mental) changes documented by MRI technology.

#### Workers' Compensation; Armed Forces Pensions

Regardless of whether one views PTSD as physical or emotional, a workers' compensation payment for PTSD should be tax free. Some states are making their workers' compensation benefits for PTSD clear. For example, Minnesota passed a bill that added PTSD to the list of covered occupational diseases under workers' compensation, and Minnesota's governor signed it into law.<sup>32</sup> Similarly, after the Sandy Hook Elementary School shooting, the

Connecticut legislature passed S.B. 823, adding PTSD as a condition covered by workers' compensation.<sup>33</sup>

Workers' compensation payments are tax free by statute with no "physical" requirement. Payments received as a pension, annuity, or similar allowance for *personal* injuries or sicknesses resulting from active service in the armed forces are too.<sup>34</sup> In *Sullivan*,<sup>35</sup> payments from the Department of Veterans Affairs were for disabilities, including PTSD, resulting from service in Vietnam. The court did not dispute that these disability payments for PTSD were excludable under section 104(a)(4).

#### Conclusion

PTSD is like many medical conditions that clearly qualify as physical sickness for purposes of section 104. In the case of many maladies, a person who may look outwardly normal may be permanently debilitated. The scientific community has verified that PTSD is observably physical, which should be sufficient for PTSD to be treated as similar to a heart attack. A payment because of either physical or emotional injury or sickness should be tax free, regardless of whether the payment comes via workers' compensation, a pension, or under a legal settlement or judgment. ■

<sup>31</sup>*Domeny v. Commissioner*, T.C. Memo. 2010-9.

<sup>32</sup>Minnesota Department of Labor and Industry, "Worker's Compensation Bill Passes" (May 2013).

<sup>33</sup>Fred Hosier, "State to Add Post Traumatic Stress Disorder to Workers' Comp Coverage," SafetyNewsAlert.com, May 20, 2013.

<sup>34</sup>See section 104(a)(4).

<sup>35</sup>*Sullivan v. United States*, 46 Fed. Cl. 480 (Fed. Cl. 2000).